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The Implementation of Accounting Standards for Islamic Banks: A Study of Preparers' and Auditors' Opinions in Sudan

by

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In the Name of Allah, the Most Beneficent,
The Most Merciful

To my parents, Gurashi and Sarah and my brothers and sisters

Abstract

The purpose of this study is to investigate the opinions of financial statements' preparers and their external auditors on the implementation of accounting standards for Islamic banks in Sudan. A major interest of this study is to examine these issues in the setting of an emerging market economy, namely that of Sudan. Sudan represents a critical case in testing whether the theoretical propositions developed in Western countries (e.g., the USA) can help explain the opinions of preparers and auditors on new accounting standards. The number of Islamic banks and audit firms in Sudan is still limited, a matter that renders the choice of a sampling approach quite problematic. A single (embedded) case study, with cross-sectional comparisons, provides an alternative approach that offers generalisations about the relevant theoretical propositions. Questionnaires, interviews and examination of documents were used as methods of data acquisition.

The findings of the present study support the propositions relating to the cost of compliance and the listing status. This supports the view that the opinions on, and attitudes towards, the disclosure standard in Sudan are driven by variables similar to those in the USA. The findings also support the size proposition pertaining to measurement standards, which considers size as proxy for political costs. The ownership proposition, in which public (state) ownership is related to political costs, is also supported. Hence, opinions and attitudes towards measurement standards could largely (but not altogether) be explained by the same variables identified in the prior research literature. As for the audit risk, the findings do not support the two theoretical propositions included in this study. Unlike the case in the USA, auditors' opinions in Sudan on the implications of audit risks associated with the implementation of the accounting standards are not explained by the same variable (i.e. proportion of receivables to total assets). The finding however, is subject to the problem of sparse data. Apart from the problem of sparse data might be explained by the fact that there are only five auditors in the present study. Another reason might be that training and regulation are predominant in the USA professional bodies (e.g., AICPA), whereas the Sudanese professional bodies (e.g. SCCA) do not consider training and regulation in the context of auditing Islamic banks in Sudan.

Despite the limitations associated with possible social desirability bias and the limited number of banks and audit firms, the findings provide evidence for AAOIFI to work with other interested parties (e.g. the CBS and KSE) in order to have its present and future accounting standards fully implemented as mandatory requirements in Sudan. Moreover, the findings spell out certain implications for the CBS as the country's banking regulatory body. The CBS may accordingly find it useful to assess the implementation of accounting standards issued by AAOIFI. Implementing the AAOIFI's accounting standards will improve the regulatory system established to supervise the Islamic banking sector in Sudan. The results also have implications for professional bodies in Sudan. The SCCA may find it useful to assess those implications for audit risk associated with the implementation of thc standards. Such implications should be considered in decisions about formulating new training and audit programmes.

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List of Abbreviations

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AICPA	American Institute of Certified Public Accountants
AR	Audit Risk
ARM	Audit Risk Model
ASE	American Stock Exchange
AT	Agency Theory Model
CBS	Central Bank of Sudan
CMC	Central Bank *Mudaraba* Certificate
CR	Control Risk
DR	Detection Risk
EA	External Auditor
FASB	Financial Accounting Standard Board
EAs	External Auditors
FM	Financial Manager
GM	General Manager
GPLA	General Price Level Adjustment
HSSB	Higher Shari'a Supervisory Board
IAH	Investment Account Holders
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IM	Investment Manager
IOSCO	International Organization of Security Commissions
IR	Inherent Risk
KSE	Khartoum Stock Exchange
MGRs	Managers
NYSE	New York Stock Exchange
OR	Occurrence Risk
SAS	Statement of Auditing Standard

SCCA	Sudanese Council of Chartered Accountants
SFA	Statement of Financial Accounting
SSB	*Shari'a* Supervisory Board
UK	United Kingdom
USA	United States of America

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PART 1 Historical Background

Chapter 1

Introduction and Background to the Research

1.1 Introduction

The present section deals with the identification of the problem, research objectives and the significance of the research study.

1.1.1 Identification of the problem

This thesis is concerned with the opinions about, and attitudes to, the implementation of new accounting standards on the part of preparers and external auditors (EAs) of financial statements. More specifically, it is concerned with attitudes and opinions in the context of Islamic banks in Sudan. Attitudes of preparers to new or proposed accounting standards have received substantial coverage in the accounting research literature. This coverage has taken place in Western countries (e.g., the USA). A major interest of this thesis is that it examines the same issues in the setting of a less-developed economy, namely Sudan. Another major interest is that the preparers in this case are the managers (MGRs) of Islamic banks. And the accounting standards in questions deal with issues that arise because Islamic banks engage in transactions using *Shari'a* compliant financial instruments, which are categorically different from those used by conventional banks.

The standards also have the backing of the Central Bank of Sudan as the supervisor of the banking sector in Sudan. The sector operates according to Islamic *Shari'a's* rules and principles. Therefore, the improvement of the transparency of financial reporting, by means of appropriate accounting standards, is intended to extend *Shari'a* compliance into the financial reporting processes, which is also a new development. Additionally, this thesis also considers the opinions of external auditors EAs on audit risk associated with new and proposed accounting standards, an important topic on which relatively little research literature exists. In general, a number of theoretical propositions have been advanced to explain and predict the behaviour of preparers to new or proposed accounting standards in Western countries. With regard to the EAs, the normative professional literature on the evaluation of audit risk and business risk suggests some theoretical propositions regarding likely EAs' opinions and attitudes. The present research study attempts to see how far the theoretical propositions can help explain the behaviour of MGRs of Islamic banks and EAs in Sudan.

Generally speaking, the implementation of a new set of accounting standards is likely to encounter potential problems, as in the case of accounting standards issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). AAOIFI's accounting standards do constitute a new set of standards for Islamic banks. Their implementation will generate a number of problems. It follows that some specific questions need to be addressed, such as:

- To what extent do MGRs of Islamic banks display positive or negative attitudes towards, and opinions on, the implementation of AAOIFI's accounting standards and why?
- How do the Islamic banks differ in their actual implementation of AAOIFI's accounting standards and why?
- How do the EAs evaluate the implications for audit risk associated with the implementation of AAOIFI's accounting standards and why?
- What are the main findings of this study that could be addressed in future research?

1.1.2 Research objectives

The research study attempts to achieve the following four general objectives:

1- to examine Islamic bank MGRs' opinions on, and attitudes towards, the implementation of AAOIFIs' accounting standards.

2- to compare and contrast the implementation of AAOIFI's accounting standards in a number of Islamic banks in Sudan.

3- to examine EAs' evaluation of the implications for audit risk associated with the implementation of AAOIFIs' accounting standards.

4- to explore issues relating to the findings of the present study, which could be addressed in future research.

1.1.3 Significance of the study

The present study is expected to be significant in terms of the following:

1- The present study contributes to the understanding and knowledge of Islamic banking and finance, with particular reference to the regulation of financial reporting.
2. It is intended to assist the CBS as the country's banking regulatory authority to establish a package of remedies for addressing problems that may result from the implementation of AAOIFI's accounting standards.
3. It is also intended to support AAOIFI's efforts to have its accounting standards implemented through persuasion of regulatory authorities such as central banks and monetary agencies in other countries, where Islamic banks operate.
4. It is further intended to improve the understanding and awareness of EAs with regard to audit risk in the context of auditing Islamic banks.

1.2 Emergence of Islamic banking system

Hamoud (1985, p.19) states that 'Caravans used to make two trips north and south to and from *Mekka*; these journeys were known as the summer and winter trips and were mentioned in the *Qura'n* (Sourah 106, verse 2)'. Various forms of primitive deposit and utilization of money appeared in pre-Islamic *Mekkan* society. The *Mekkans* knew two methods of utilization of money, namely (1) giving money in commenda for a share of profit; and (2) lending based on usury (the meaning of usury will be stated in section 1.3 below), which was common in pre-Islam among the Arabs and between the Arabs and Jews. Islam is a revealed religion of compassion and guidance to rectify the deviations in belief, to establish justice, and to guide human life into righteousness and goodness. The importance of financial institutions increased in the early stage of Islam, with particular reference to the rule of the *Amoian* and *Abasian*[1], during which time accounting principles evolved in accordance with Islamic precepts (Atia, 1989, pp. 59-60). During the rule of the Ottoman Empire, the Islamic State experienced some institutional stagnation (Ali, 2001). This stagnation had an adverse effect on the development of an Islamic system of accounting concepts and techniques relating to financial institutions and instruments, which, from the 17th century AD, emerged vigorously in European countries and in North America. In the process of this development in the West, those financial institutions and instruments that are based on interest played a principal role in the market economy. By contrast, there was no parallel development of Islamic financial instruments (based on strict Quranic doctrines) to avoid usury. Consequently, Muslims seriously came to face the problem of choosing between financial services that involved interest, and foregoing the use of such financial services. With the turn of the twentieth century came the discovery of oil in the Arab world and most of the international powers came to exploit this newfound wealth. Subsequently, during the second half of the 20th century, Muslim scholars started making efforts to develop acceptable modes of finance and institutions to offer them. Those efforts gained further momentum following the rise of the oil price in the 1970s, a situation which created the need for "recycling petro-dollars". Most of that "recycling" was actually performed by North American and European banks, using interest- based instruments.

The establishment of local savings banks in Egypt in 1962 was the first attempt to put Islamic banking theory into practice. However, that experience was abandoned later in 1968. Then Nasir Social Bank was founded in 1971 as an Islamic financial institution. A number of other Islamic countries also witnessed the birth of various Islamic banks. Subsequently, an agreement was reached and signed by 23 Islamic countries in August 1974, approving their participation in the capital of the Islamic Development Bank[2].

In Sudan, the banking sector, before independence in 1956, consisted of seven foreign banks. The Bank of Sudan was established in 1959 in accordance with a Special Act. Up to 1977 savings and time deposits' returns and all advances granted by banks to their clients were interest-bearing modes. During the period of 1977-1983 the banking sector passed through conventional Western

[1] The rule of *Amoian* (661-750 AD) and *Abasian* (750-1258 AD) was established after Islamic *Khalafa*

banking with the exception of initiatives by pioneers in the Islamic banking field, such as Faysal Islamic Bank, Tadamun Islamic Bank, Sudanese Islamic Bank, Export Development bank (formerly West Islamic Bank) and Al-Baraka Bank. In 1983 the Bank of Sudan required all banks and other similar financial institutions to abolish interest on all types of business transactions and to comply with alternative Islamic modes of finance. The total number of banks in 1997 reached 28 (including 4 foreign banks) with 658 branches[3] (Awatif et al. 1997).

However, some problems and difficulties arose during the implementation of the new modes of finance. To overcome these problems the Bank of Sudan issued in-depth directives on the concept of Islamic modes of finance. In this regard, sustained efforts were made to further and develop various Islamic modes of financing, including *Murabaha and Murabaha to the Purchase Orderer*, *Salam* sale, *Istisn'a* and *Ijarah*[4]. According to the 1991 Banking Regulation Act the Higher *Shari'a* Supervisory Board (HSSB) was established in March 1992 with the responsibility to issue *Fatwas* [*Shari'a* formal legal opinion or rulings] and review contracts governing all business transactions for the central bank as well as commercial banks. Subsequently, each Islamic bank in Sudan has been required to form a *Shari'a* Supervisory Board (SSB) in order to ensure that all its banking transactions are executed strictly according to Islamic doctrine. The banking policy (1999-2000) addresses the revision of the 1991 Act in order to realize proper *Shari'a* compliance by Islamic banks. Moreover, the policy is concerned with the issuance of the Central Bank *Mudaraba* Certificate (CMC)[5] in order to ensure their juristic correctness.

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[2] See, *Al-Masarif*, Beirut, 9th year No. 190 September 1974.
[3] At the time of writing this thesis, a branch of a foreign bank was voluntarily liquidated and two national banks are under liquidation
[4] These modes of finance will be discussed in section 1.4 below.
[5] CMC has been launched as alternative to interest-bearing government securities in order to improve a commercial bank's liquidity. Meanwhile, the banks may realize profit through auction of certificates.

1.3 Meaning of *riba* (usury)

Linguistically *riba* (usury) means "increase and growth". The purely linguistic meaning of *riba* is thus the increase of an amount of money due in consideration for the extension of credit terms on a loan[6]. The Holy *Quran* explicitly and emphatically prohibits *riba*[7]:

Those who eat *riba* [usury] will not stand (on the day of resurrection) except like the standing of a person beaten by Satan leading him to insanity. That is because they say 'trading is only like *riba*,' whereas Allah has permitted trading and forbidden *riba*. So whosoever receives an admonition from his lord and stops eating *riba* shall not be punished for the past [deeds], but whosoever returns to *riba*, such is the dweller of fire.

In the *Sunna* [sayings and deeds of the Prophet Mohammed (God's prayers and peace be upon him)], it was reported that "However, every usury of pre-Islam is abolished, you are entitled to take your capital so that you do not oppress others and you are not oppressed' (Hamoud, 1985, p.48). The banning of usury is also related to the exchange or sale of certain kinds of goods, namely commodities, and metals used as money. In this regard, Abu Hurira reported that: "Gold for gold, weight for weight, similar for similar; silver for silver, he who increases or asks for an increase commits usury"[8].

As mentioned by Islamic jurists, the banning of usury is derived from the Holy *Qura'n*, *Sunna* and *Ijmah* (consensus) among Islamic scholars. Accordingly, Hamoud (1985, p.65) points out the adverse effect of usury on individuals and society. He argues that it is not possible to restrict the social injury of usury (*riba*) to dealers therein only, because the direct detrimental effects will cause damage and evil to the whole society. According to Abu Huraira, the Prophet (God's prayers and peace be upon him) said: "There comes a time on people when they eat usury, he who does not eat it will be hit by its dust"[9].

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[6] See Mohedin Sharaf AL-Nawawi: ***Tahzeeb Alazman Walawgat***, section 2, part I (Egypt, Cairo Printing House).
[7] *Surah* 2 *Al-Bagarah*, verse 275. The interpretation of the meaning of this verse is quoted from a summarized version of *Al-Tabari*, *Al-Qurtubi* and *Ibn Kathir* with comments from *Sahih Al-Bukharri*. Translation was given by Al-Hila'li and Khan, Dar-us-Salam Publications, Rayadh-Sudi Arabia, 1996.
[8] See *Sahih* Muslim, the interpretation of this *Hadaith* was given by *Al-Nawawi.*, part II
[9] The interpretation of this *Hadaith* was given in *Sahih* El-*Bukharri*, part I.

In short, there seems to be a complete consensus among all schools of Islamic thought that the term *riba* (usury) stands for interest in all its types and forms (Hamdi, 1986, p.155). In this respect, the majority of modern *Fugaha* (Islamic scholars) interpret *riba* as being equivalent to interest (Karim, 1999, p. 34). More precisely, *riba* is a pure return (or rent) on money per se, where neither business risk is borne nor other goods or services are provided. Islam permits returns from financing in the context of transactions in real assets (See sections 1.4.3 and 1.4.4 below).

1.4 Islamic modes of finance as an alternative to usury-based modes

Islamic banks are established according to a set of fundamental principles; the most important of which are those of profit and risk sharing, joint venture and permissible forward contracts. These are set out in accordance with Islamic *Shari'a's* rules and principles. An Islamic bank does not deal with *riba*. Instead, it mobilizes funds, among other methods, under a system of profit-and-risk sharing through *Mudaraba* contracts (whether restricted or unrestricted). In the act of using those funds an Islamic bank employs a number of financial instruments, which are described below. The first two (*Mudaraba* and *Musharaka*) are partenership or profit-and-loss sharing modes of finance, the next three are credit-based instruments, and the last two are forms of leasing.

1.4.1 *Mudaraba* finance

Mudaraba is a form of partnership in which one or more partner(s) provide(s) funds to another to invest in a project. The provider of the funds is known as *Rabb-ul-mal,* and the other, who manages the investment, is known as *Al-Mudarib* (AAOIFI, 1993a). One of the main conditions of the *Mudaraba* contract is the separation of ownership from management. There are special characteristics of *Mudaraba* that distinguish it from other financial instruments (e.g., *Musharaka*). These are:

1. In a *Mudaraba* contract, the management of the invested funds is the exclusive responsibility of the *Mudarib*; while in a *Musharaka* contract, all partners may participate in the management of the business.

2. In *Mudaraba,* one party provides the funds and the other party provides the effort; whereas in *Musharaka* all partners provide funds.

3. If any profit is realized in a *Mudaraba, Al-Mudarib* receives a *Mudarib's* share (as a pre-determined percentage)[10] from the returns on the invested funds. However, in case of loss, *Rab-ul-mal* bears the loss, provided that it was not due to misconduct or negligence on the part of the management (*Al-Mudarib*). By contrast, in a *Musharaka,* all parties to the contract bear the loss according to their share in the invested funds.

4. Assets acquired by *Mudaraba* finance are in the sole ownership of *Rab-ul-mal.* By contrast, in a *Musharaka,* the partners jointly own the assets acquired by *Musharaka* finance.

There are two types of *Mudaraba* contract: unrestricted (discretionary) and restricted *Mudaraba*

a. Unrestricted *Mudaraba:*

Under this type the investment account holders (IAHs) authorize the bank to invest their funds in a manner which the Islamic bank deems appropriate without laying down any restrictions as to where, how, and for what purpose the funds should be invested (AAOIFI, 1996b). According to the terms and conditions of a *Mudaraba* contract, the IAHs are permitted to withdraw their funds at short notice subject to some loss of the profit share. Moreover, the bank in its capacity as *Mudarib* is entitled to receive a share of the profit when the invested funds generate a return. Yet, in case of loss, the bank receives no remuneration or share as *Mudarib* (Karim, 1995 and Archer and Karim, 1997). However, the bank may have the right to deduct a certain percentage from the net profit on IAH's funds in order to create a reserve. This reserve is primarily used to meet potential losses on IAHs' funds and it is also used to compensate IAHs during periods of low profit on the invested funds. The bank may also forego part of its profits or *Mudarib* share in favour of IAHs in order to offer a competitive rate of return (Archer et. al., 1998).

[10] The *Mudarib's* share is determined by the bank's management policy (normally ranges from 10% to 20%).

b. Restricted *Mudaraba:*

With this type the IAHs impose certain restrictions as to where, how and for what purpose their funds are to be invested (AAOIFI, 1993b and 1996b). A bank (as *Mudarib*) uses IAHs' funds according to the terms and conditions specified in a restricted *Mudaraba* contract. Moreover, the Islamic bank is restricted from commingling its own funds with the restricted investment account funds. In both restricted and unrestricted *Mudaraba*, *Al-Mudarib* cannot indemnify IAHs for any loss incurred, except when negligence or misconduct on the part of management has occurred (Archer, et al. 1998).

1.4.2 *Musharaka* finance (profit/loss sharing instrument)

Musharaka is a form of partnership involving two or more parties. Each party contributes to the capital of the partnership equally or in varying proportions so as to invest in a joint venture. In *Musharaka* each party becomes a part-owner of the acquired assets and is entitled to his due share of profits. However, each partner also bears the loss in proportion to his contributed capital. There are three types of *Musharaka* (AAOIFI, 1996c), namely;

a. Constant *Musharaka:*

   Constant *Musharaka* is defined as "*Musharaka* in which the partners' shares in the capital remain constant throughout the period as specified in the contract".

b. Diminishing *Musharaka:*

   In diminishing *Musharaka*, one partner agrees to transfer gradually to the other party its share in *Al-Musharaka*. Therefore, as a partner's share declines, the other partner's share increases until the latter becomes the sole owner of the venture.

c. Equity Joint Venture:

An equity joint venture is defined as: "*Musharaka* in which an Islamic bank owns shares or units representing an equity stake in another firm's capital" (Ibid. 1996a).

1.4.3 *Bai Muajjal* (Deferred sale)

Al-Bai Muajjal is described as a sale under which the price of the item involved is payable on a deferred basis, either in a lump sum, or in installments. This mode could be of considerable use to supply credit to industry and agriculture, as well as to finance domestic and import trade. Although the latter mode is considered to be permissible under Islamic *Shari'a* rules and principles, some commentators argue that it is not advisable to use it widely and indiscriminately in view of the impending risk of opening a back door for dealing in an interest-based system (Hamdi, 1986, p. 158). For instance, *Murabaha* may degenerate into a loan for which a charge is made with the asset never actually becoming the property of the bank. This transaction is in fact a loan made in return for an interest charge and thus represents a form of *Haram* (non-permissible) transaction. Safeguards would, therefore, need to be devised to restrict the use of this mode of finance. In this regard, the Bank of Sudan, in consultation with HSSB, has asked Islamic banks and similar financial institutions to restrict *Murabaha* sales in order to avoid such transactions.

There are three types of *Bai Muajjal.* These are: *Murabaha, Salam* and *Istisna'a*

Murabaha and Murabaha to the Purchase Orderer:

A *Murabaha* is defined as: "a sale of commodity at cost plus an agreed profit mark-up". *Murabaha to the Purchase Orderer* is defined as:' A sale in which two parties or more negotiate and promise each other to execute an agreement according to which the orderer (i.e., the client) asks the purchaser (i.e., the bank) to purchase an asset of which the latter takes the legal possession' (AAOIFI, 1996a).

The client promises the bank to purchase the asset from it. The two parties would conclude a sale when the orderer takes possession of the asset from the bank. However, the purchase orderer's promise may or may not be binding on him to conclude the sale. There are thus two types of *Murabaha to the Purchase Orderer,* namely binding and non-binding promise (See Appendix 1 below).

The salient characteristics of *Murabaha* that distinguish it from a loan or overdraft facility consist of the following:

a) The bank pays the supplier and should therefore acquire legal ownership of the asset (asset becoming the property of the bank).

b) The bank should inform the orderer about the price at which it purchased the asset, and stipulate an amount of profit mark-up in addition to the cost of the goods.

In order to ensure a smooth settlement of debts due to the bank, some *Shari'a* scholars allow a fine to be imposed on delinquent clients, provided that the amount of the fine is not included in the income statement of the Islamic bank, and is eventually donated to charity. Moreover, from the viewpoint of modern Islamic scholars (jurists), solvent debtors should be subject to punishments for non-payment, including the confiscation of the goods or assets, and the necessary civil and criminal procedures should be taken against defaulters[11]. This is because delays and defaults without genuine reasons (procrastination in payment by a solvent debtor) would not only be a breach of trust, but would also jeopardize the success of *Murabaha* as an alternative to the interest-based mode of finance. However, the assets supplied in a *Murabaha* contract provide collateral for the debt, and may be re-possessed by the bank (creditor) in the event of default.

Salam:

Salam is defined as "purchase (or sale) of goods for deferred delivery in exchange for immediate payment"[12].

The validity of a *Salam* contract depends on certain conditions which include the following:

1. The purchase price should be known.

2. The receipt of the *Salam* payment should take place where the contract is established.

[11] See AAOIFI, "Juristic rules of *Murabaha and Murabaha to the Purchase Ordeerr*, 1996, Bahrain.
[12] See AAOIFI,, FAS 7 and see also Ahmed Ali Abdallah, Juristic rules of *Salam* contract, 1996, Bahrain.

3. The commodity (*Al-muslam fihi*) should be subject to strict identification so as to negate lack of knowledge of its kind, type, quality and amount.

4. *Al-muslam fihi* should be subject to specification and it should be recognized as a debt.

Istisna'a:

Istisna'a is defined as:

'A sale contract between *al-mustasni'* (the ultimate purchaser) and al-sani' (seller), whereby *al-sani'* - based on an order from *al-mustasni'*- undertakes to have manufactured or otherwise acquired *al-masnoo* (subject matter of the contract) according to specification and sell it to *al-mustsni'* for an agreed upon price and method of settlement whether that be in advance, by installments or deferred to a specific future time' (AAOIFI, 1998b).

In other words, the purchaser asks the seller to supply a specific product for an agreed upon price and method of payment. The conditions of validity of *Istisna'a*, include the following:

1. *Al-masnoo* must be known and specified to the extent of removing any lack of knowledge of its kind, type, quality and quantity.

2. A future delivery date should be fixed.

3. The price of *al-masnoo* should be known.

Salam and *Istisna'a* are forms of working capital finance. *Salam* was originally introduced for the agricultural and horticultural producers as a form of crop pre-financing, while *Istisna'a* is introduced for financing work-in-progress inventories in manufacturing or construction. Both *Salam* and *Istisna'a* can be used in a parallel mode. That is, the bank (financier) may enter into a forward contract [i.e. the goods are already sold to a third party for immediate payment, thus hedging the goods' price risk]. However, any such forward contract must be legally independent of the original contract.

1.4.4 *Ijarah* (leasing)

Ijarah is defined as 'the transfer of the services of an asset for an agreed upon consideration'. Some *Fugaha* (jurists) have defined *Ijarah* as 'Ownership of the right to the benefits of using an asset in return for consideration' (AAOIFI, 1997c). *Ijarah* is an alternative way of financing fixed assets. According to Islamic scholars *Ijarah* has three elements:

1. Two parties: a lessor (the owner of the leased asset), and a lessee (the party who receives the services of the leased asset).

2. A contractual form that includes an offer and consent.

3. The subject of the *Ijarah* contract, which includes the rental amount and the services which, are transferred to the lessee.

There are two types of *Ijarah*, namely:

Operating *Ijarah:*

This is an *Ijarah* contract that does not end up with the transfer of ownership of the leased assets to the lessee.

Ijarah Muntahia Bittamleek:

An *Ijarah* contract stipulates that the transfer of ownership of the leased asset to the lessee.

Differences between a conventional lease and an Islamic *Ijarah* (lease) are summarized below.

1. Contracts in a conventional lease can be altered, while in an Islamic lease they cannot be subject to alteration.

2. In a conventional finance lease, the economic substance of the situation is that the lessee has an asset and a matching liability, although the legal form is that the ownership of the asset remains with the lessor [i.e. substance over form]. By contrast, in Islamic *Ijarah*, the lessor retains the responsibility of ownership [i.e. the legal form and possession of the leased asset remain with the lessor]. So that the lessor is responsible for maintaining the

leased asset and carrying out all repairs that would make it available for use, as well as for its insurance.

1.5 Summary and concluding remarks

The application of *Shari'a* to business transactions has resulted in the emergence of a number of Islamic banks in some Islamic countries (e.g., Sudan), where central banks have required all Islamic banks and other financial institutions to abolish interest. Unlike conventional banks, Islamic banks are established with the mandate to carry out their financial transactions in accordance with the rules and principles of Islamic *Shari'a*. This influences the capital structure and investment activities of Islamic banks in various ways. Islamic banks mobilize funds through investment accounts on the basis of a profit-and-loss sharing mechanism in place of the interest based- modes. As alternatives to lending funds and charging interest thereon, Islamic banks use various instruments of Islamic finance, including partnership or profit-and-loss sharing modes (*Mudaraba* and *Musharaka* financing), credit based instruments (e.g., *Murabaha, Salam and Istisna'a*), and leasing (*Ijarah*).

Although each of the above Islamic modes of financing, as used by Islamic banks, has some characteristics, which resemble those of financial instruments used, by conventional banks, each of the Islamic instruments of finance has specific juristic rules that have no parallels in the conventional financial instruments. AAOIFI's work should be seen as complementary to that of the International Accounting Standards Board (IASB). In many ways they have similar aims, namely the improvement and international harmonization of financial reporting rules and practices in the interest of transparency and comparability in an increasingly global financial marketplace. However, international accounting standards (IAS) do not consider the specificity of Islamic banks and the financial instruments as used by them (see Chapter 2 below). Hence, in Islamic banking, the use of IASs as a means for achieving international harmonization of financial reporting is unlikely to be long effective. This provides a rational justification for AAOIFI's work in regulating financial reporting by Islamic banks by reference to accounting standards that address the unique characteristics of Islamic financial instruments.

Chapter 2

International Accounting Self-Regulatory Bodies: A Comparison Between the IASB and AAOIFI

2.1 An overview of accounting regulation

Issues of financial accounting regulation have preoccupied both practitioners and academics for a number of decades in Western countries, in particular the United States of America (USA) and the United Kingdom (UK). As a result, intensive research and numerous studies (e.g., empirical research and the work of standard setting bodies) have been carried out for the last seven decades. Bromwich (1992, p. 250) states that the system of accounting regulation varies between countries and has undergone changes over the years. For example, France and Germany have largely depended on a statutory system; whereas Australia and Canada have employed a mixed system, i.e. a combination of statutory and self- regulatory systems. On the other hand, the UK (in particular before the 1981 Companies Act) and the USA provide examples of self-regulatory systems. Notwithstanding, the respective statutory systems and governmental mechanisms directly or indirectly influence the USA and the UK systems. Specifically, the Securities and Exchange Commission (SEC) delegates part of its regulatory power to the Financial Accounting Standard Board (FASB), and thus has an influence on it.

A regulatory system can take one of the following forms.

a) The separation model, in which banks are not allowed to conduct securities business or to own securities firms.

b) The universal banking model, in which banking and securities businesses are freely combined within the banking entity.

c) The firewall model, in which banking and securities operations within the same banking group undertake their business through different legal entities separated by "firewalls".

Islamic banking is a form of the universal banking model. In other words, Islamic banking deals with commercial and investment business, but in accordance with the rules and principles of Islamic *Shari'a*.

The remainder of the chapter is structured as follows:

Section 2 provides information about IASB and AAOIFI. Section 3 shows similarities and differences between the IASB's and AAOIFI's frameworks. A comparison between IASs and AAOIFI's accounting standards is presented in section 4. Section 5 provides summary and concluding remarks.

2.2 Information about IASB and AAOIFI

The present section presents the basic information about International Accounting Standard Board (IASB) and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in the following order.

2.2.1 IASB

IASB is an independent, private self-regulatory body, founded in 1973 as the International Accounting Standard Committee (IASC) [13]. The main objectives of the IASB as stated in its constitution are:

a. to formulate and publish in the public interest, accounting standards to be observed in the presentation of financial statements, and to promote their world-wide acceptance and observation.

b. to work generally for the improvement and harmonization of regulation, accounting standards and procedures relating to the presentation of financial statements.

As of September 2002, the members of IASB were 154 professional accounting bodies in 112 countries[14]. The IASB ensures that IASs are developed only through an international due process, which involves the worldwide accountancy profession, the preparers and users of financial statements. In 1995, the IASC entered into an agreement with International Organization of Security Commissions (IOSCO), which states that: IOSCO would consider endorsing IASs for cross-border capital raising and listing purposes in all global markets once a core set of standards had been completed. In 1999, the IASC achieved its target of issuing new or revised accounting standards covering all the items agreed with IOSCO (Alexander and Archer, 2000, ch1). The IOSCO and many stock exchanges accepted IASs for cross-border listing purposes; however, notable exceptions were the USA and Canada.

It might be argued that the financial crisis, which began in certain Asian countries (e.g. Indonesia) and spread to other regions of the world, showed the need for credible, comparable and transparent accounting information to help sound decision making by investors, lenders and regulatory authorities. Yet, the IASB as an international self-regulatory body has no statutory power to enforce its standards. The board relies on the quality of its pronouncements to persuade governments, stock exchanges and other regulatory bodies to back the implementation of its accounting standards.

2.2.2 AAOIFI

AAOIFI, formerly known as Financial Accounting Organization for Islamic Banks and Financial Institutions, was established in accordance with the agreement of association, which was signed by Islamic financial institutions in 1990. The AAOIFI was registered as an international self–regulatory body in 1991 in the State of Bahrain. The main objectives of AAOIFI as stated in the its constitution (see Article IV) are:

[13] The name and constitution of IASC were changed in 2000.
[14] Source: http: // iasc.org.uk/frame/cen1.htm.

a. to develop accounting and auditing thought relevant to Islamic financial institutions.

b. to disseminate accounting and auditing thought relevant to Islamic financial institutions and its applications through training, seminars, publication of periodic newsletters, carrying out and commissioning of research.

c. to prepare, promulgate and interpret accounting and auditing thought relevant to Islamic financial institutions.

d. to review and amend accounting and auditing thought relevant to Islamic financial institutions.

The organization structure of AAOIFI consists of a general assembly of 75 Islamic institutions from 16 countries. The AAOIFI has a board of trustees and a board of accounting and auditing standards, each consisting of 15 members, a *Shari'a* Board consisting of not more than 15 part-time members, an executive committee, and a secretary-general who is a full-time executive and heads the general secretariat.

As in the case of the IASB, the AAOIFI has an extensive due process that governs the production of its accounting and auditing standards, however the due process includes checking of *Shari'a* juristic suitability of the proposed standards by the *Shari'a* committee. The AAOIFI invites interested parties to express their opinions on the proposed statements and standards before their final approval. The AAOIFI also holds two public hearings in two different countries to discuss exposure drafts.

As of September 2002, AAOIFI had promulgated two statements on objectives and concepts of financial accounting for Islamic financial institutions, eighteen financial accounting standards, four auditing standards, four governance standards, thirteen *Shari'a* standards, and two code of ethics for accountants and auditors, and for employees. Moreover, the AAOIFI has issued one statement on capital adequacy for Islamic banks. The total number of AAOIFI's authoritative pronouncements was 44 (AAOIFI, 2002).

Like the IASB, AAOIFI, as a self-regulatory body, has no power to enforce its respective standards. The AAOIFI depends on the quality of its pronouncements to persuade governments, central banks, monetary authorities, and stock exchanges to support the implementation of its accounting standards in some Islamic countries. However, it would not be an easy job for AAOIFI to have all Islamic countries adhere to its standards because of existing different legislation and regulatory requirements.

2.3 The IASB's and AAOIFI's conceptual frameworks[15] (CF)

The IASC (1989) developed a framework for the preparation and presentation of financial statements (hereafter the Framework). The Framework provides general guidelines for future accounting standards. It also aims to support national standard-setting bodies in developing national accounting rules that comply with the IASs. The Framework includes the objective of financial statements, basic assumptions and principles such as the accrual basis, the going concern assumption, and four qualitative characteristics of information in financial statements, which are understandability, relevance, reliability and comparability. The framework also includes the concept of capital and capital maintenance (IASC, 1989).

AAOIFI followed a similar approach to that of the FASB's conceptual framework in starting its standard-setting by promulgating two statements on the objectives and concepts of financial accounting for Islamic banks and financial institutions. More specifically, AAOIFI's Framework (AAOIFI, 1993) provides general rules for accounting standards for Islamic banks and financial institutions. The Framework covers the Objectives of Financial Accounting for Islamic Banks and Financial Institutions (hereafter the Statement of Objectives). AAOIFI's framework also covers the Concepts of Financial Accounting for Islamic Banks and Financial Institutions (hereafter the Statement of Concepts). The Statement of Concepts (SFA 2) defines the basic elements of financial statements, which are included in the following sets:
1) Statement of financial position, 2) income statement, 3) statement of changes in owners' equity or statement of retained earnings, 4) statement of cash flow, 5) statement of changes in restricted

[15] AAOIFI's conceptual framework means its two Statements on Objectives and Concepts of Financial Accounting

investment, 6) statement of sources and uses of funds in *Zakat*, and 7) statement of sources of funds in the *Quard* fund (AAOIFI, 1993b pars 21-64).

AAOIFI's Statement of Concepts also cites four basic accounting assumptions, which include going concern, the accounting unit concept, periodicity, and the stability of the purchasing power of the monetary unit concept (ibid. pars 65-80). The Statement of Concepts defines accounting recognition of revenues, expenses, gains and losses in the bank's income statement and recognition of profits and losses in the statement of changes in restricted investments (ibid. pars. 81-86). As for measurement of financial instruments, cash equivalent value and historical cost (par 95) are most commonly adopted in the Statement of Concepts (see pars 89-94 and 95). AAOIFI's Statement of Concepts also cites five main qualitative characteristics: relevance, reliability, comparability, consistency and understandability (ibid. pars.103-122).

2.4 Comparison of IASs to AAOIFI's accounting standards

At present, financial reports prepared for shareholders and other users involve principles and procedures that can vary widely from one country to another, and sometimes even within a country. Financial reports, therefore, lack comparability. This creates the need for international accounting standards, in order to achieve the goal of the improvement and harmonization of financial reporting rules and practices.

IASs are intended to be applicable to all commercial, industrial and the business enterprises in the public and private sectors, with the exception of IAS 30 "Disclosure in the financial statements of banks and similar financial institutions", which applies to banks and similar financial institutions (Dalton, 2000). While IASs are not issued to be applicable to the products of *Shari'a* compliant transactions, AAOIFI's accounting standards are specifically designed to disclose the products of transactions based on the rules and principles of Islamic *Shari'a*. For example, IAS 30 does not apply to the products of free-interest financial transactions as reflected in the financial position of an Islamic bank.

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for Islamic Financial Institutions.

Although some IASs deal with financial instruments that are the conventional alternatives of those dealt with by AAOIFI's accounting standards, the two sets of the standards are in some cases incompatible. More specifically, *Murabaha and Murabaha to the Purchase Orderer* standard (FAS 2) deals with accounting treatments of *Murabaha* credit-sale instrument. The accounting treatments are not compatible with the requirements of IAS 18 "Revenue", (for more details see 2.4.2 below). There are also IASs for which there are no comparable accounting standards issued by AAOIFI, one reason for this is that the financial statement items covered by IASs do not address any issue of *Shari'a* requirements. Thus, AAOIFI has not needed to issue separate accounting treatments for such items such as property, plant and equipment (e.g. IAS 16). Another reason is that the types of conventional financial instruments covered by the IASs do not appear in the financial statements of Islamic banks, as they can result only from *Haram*[16] (non-permissible) transactions, such as borrowing costs, e.g. IAS 23 "Borrowing costs".

2.4.1 IAS 30 and AAOIFI's disclosure standard (FAS 1)

IAS 30 requires specific disclosure of accounting policies; the contents of statement of financial position and the income statements or of accompanying notes to them; and off balance sheet items, including contingencies and commitments. FAS 1 "General presentation and disclosure in financial statements of Islamic banks standard" requires general disclosures in the financial statements; presentation and disclosure of statement of financial position, the income statement, cash flow statement, the statement of changes in owners' equity or statement of retained earnings, statement of cash flow, statement of changes in restricted investment, statement of sources and uses of funds in *Zakat*, and statement of sources of funds in the *Quard* fund (AAOIFI, 1993).

The main differences, which distinguish FAS 1 from IAS 30, include:

1- The financial statement items that are presented in IAS 30 are largely the product of interest financial instruments and do not feature in the financial statements of Islamic banks. Conversely, the financial statement items presented in FAS 1 are largely the

[16] The author's own italics.

results of free-interest financial instruments and do not feature in the financial statements of conventional banks.

2- Islamic banks are required to disclose earnings or expenditures prohibited by *Shari'a*, if any, in the notes to financial statements. AAOIFI emphasizes the important role of the religious and external auditors in testing whether an Islamic bank comply with *Shari'a's* rules and principles. IAS 30 does not specifically address the issue of prohibited earnings by *Shari'a* or any religious aspect.

3- Unlike IAS 30, FAS 1 presents the equity of unrestricted investment accounts, which requires separation from liabilities and owners' equity, because unrestricted investment accounts are not liabilities but are a form of limited term equity instrument with residual claims. Moreover, FAS 1 includes additional financial statements, which meet the perceived information needs of certain groups of users. These are statement of changes in restricted investment accounts, statement of sources and uses of funds in *Zakat* and charity fund, and statement of sources and uses of *Quard* fund (see Appendix 2 below).

2.4.2 IASs and AAOIFI's measurement standards

As stated above, Islamic banks mobilize and use funds through free-interest financial instruments, which have technical aspects (accounting and juristic rules) that are different from those of conventional financial instruments. IASs are not designed to be applicable to the results of *Shari'a* compliant transactions. The major differences between IASs and AAOIFI's measurement standards are discussed below.

1 *Murabaha* and *Murabaha* to the Purchase Orderer *(Murabaha)* standard

It might be stated that the issue of revenue recognition under *Murabaha* (FAS 2) falls within the scope of IAS 18 "Revenue". The IAS 18 requires the separation of a trading profit margin from a financing charge for credit, which is an interest-based instrument. The profit is recognized when the asset is made available for sale to the buyer (IAS 18 pars. 14-19), while interest is recognized on a time proportion basis over the credit period (IAS 18 par 30 (a)). By contrast, in a *Murabaha* sale, the seller's profit mark-up is not divisible into two components, a profit margin and charge for credit, since the latter would be a form of *riba*, which is prohibited by Islamic *Shari'a*. Therefore, the accounting treatments for profit recognition fairly reflect the substance of *Shari'a* compliant transaction for which the splitting of the mark-up as required for interest financial instrument would be inappropriate, even if it were in principle feasible. Hence the *Murabaha* accounting treatment of profit recognition is incompatible with IAS 18.

2 *Musharak*a Financing standard

Musharaka financing (FAS 4) is a form of equity or profit and loss (free-interest) financial instrument. It is unique to Islamic banking. The profit and loss sharing rules of *Musharaka* require an accounting treatment that may not be compatible with IASs. IAS 31 allows either of the treatments set out in IAS 28 pars 6 and 7, namely the equity method or cost method, while IAS 39 par 70 requires the cost method for an investment for which a fair value cannot be reliably determined. As for joint ventures, which are subject to joint control, IAS 31 is applicable for *Musharaka* financing. IAS 31 does not allow the cost method in such cases however it allows the equity method. FAS 4 pars. 14 and 16 requires a partner's share of undistributed profits in the *Musharaka* to be accounted for as an account receivable and not presented in the partner's capital in the *Musharaka.* This is necessary in order to apply the *Shari'a* rules for the sharing of losses. The equity method requires the share of undistributed profits to be included in the carrying amount of the investment. The carrying amount of the investment presented on the balance sheet may be split into two components: the cost element (partner's capital for FAS 4 requirements) and the share of undistributed profits (a *Musharaka* account receivable for FAS 4 requirements) Hence, FAS 4 is compatible with IAS31.

3 *Ijarah and Ijarah Muntahia Bittamleek*

As mentioned earlier in the present chapter, the principle of economic substance over legal form is a paramount aspect of reliability. In the AAOIFI's Framework, the distinction between economic substance and form is not applicable, insofar as "form" corresponds to *Shari'a* compliance. For example, the differing approaches of IASB's and AAOIFI's framework can be seen in the accounting treatments of leases. IAS 17 (IASC, 1997) distinguishes between operating leases and finance leases. A finance lease is a lease that transfers to the lessee substantially all the risks and rewards incident to ownership of the assets. An operating lease is a lease other than a finance lease (IAS 17, par. 3). AAOIFI points out that according to the *Shari'a* the lessor must retain certain risks incident to ownership of the leased asset. Hence there is no *Shari'a* equivalent of a finance lease. These differences affect accounting treatments. In the case of finance lease, the lessee treats the leased asset as its own property (fixed assets) and recognizes the corresponding liability for lease payment, while the lessor recognizes an account receivable for the lease payments. All *Shari'a*,-compliant leases are operating leases according to this criterion and thus there is no compatible between IAS 17 and FAS 8. However, the implementation of a new approach (February 2000), as suggested by G4+1[17] Discussion Paper, could result in a revision of IAS 17. This would remove the distinction between operating and finance leases. The property right of the lessee inherent in operating lease and the corresponding financial obligation should be reflected in the lessee's financial position. Hence to comply with such a revised IAS 17, Islamic banks, as lessors, would have to recognize *Ijarah* as a financial asset, not a fixed asset. Such an amendment in the sense of the discussion paper it would not be compatible will AAOIFI's FAS 8.

2.5 Summary and concluding remarks

As mentioned in chapter 1 above, many Islamic banks in a number of Islamic countries have followed either IASs or national accounting standards. However, the nature and activities of Islamic banks are substantially different from those of conventional banks. Islamic banks are required to comply with Islamic *Shari'a* rules and principles in all their financial and other dealings. Specifically, the items in Islamic banks' financial statements do not correspond in a number of cases to the items specified in a conventional bank's financial statements. This is because the financial statement items mentioned in FAS 1 are largely the results of *Shari'a* compliant transactions and are not presented in the financial statements of conventional banks. That is to say, Islamic banks mobilize and use funds through free-interest financial instruments, which have technical aspects (accounting and juristic rules) that are different from those of

[17] G4+1 includes representatives of accountancy body in Australia, New Zealand, Canada, UK and USA together

conventional financial instruments.

Unlike the IASB's Framework, the AAOIFI's Framework does not distinguish between substance and legal form insofar as "form" corresponds to *a Shari'a* requirement and is therefore part of the substance of a transaction, (e.g. revenue recognition in *Murabaha*). Moreover, the AAOIFI approach does not consider the distinction between operating leases and finance leases (FAS 8) as IASB (IAS 17) does. It appears that the accounting treatments of finance lease are not compatible with those of AAOIFI's FAS 8.

A comparison between the two sets of the standards highlights the essential differences, which result from the specifities of *Shari'a* compliant transactions. Neither IAS nor national accounting standards (NAS), which were or have been adopted by most of Islamic banks, have dealt with the specificity of Islamic banks. Thus, the use of IAS or NAS in order to realize international harmonization of financial reporting would not be effective for financial reporting made by Islamic banks. As an alternative to IASB, AAOIFI provides unique standards for regulating financial reporting by Islamic banks, in order to make their financial statements more comparable. In this regard, the CBS and Monetary Agencies in Bahrain and Jordan require Islamic banks to comply with AAOIFI accounting standards. Some Islamic banks in other countries such as Malaysia and Saudi Arabia have also started voluntarily to comply with AAOIFI accounting standards.

The implementation of the accounting standards as a new phenomenon would be expected to receive considerable attention from professionals such as preparers of financial statements (e.g., managers) and external auditors. The implementation of AAOIFI's accounting standards raises a number of issues similar to those raised by the implementation of any new set of accounting standards. These issues include the reception of the standards by financial statements' preparers and auditors, whose opinions and attitudes may have an important bearing on the success of the implementation. It is the purpose of this thesis to examine preparers' and auditors' opinions about, and attitudes towards, the implementation of AAOIFI's accounting standards in Sudan, in the light of previous academic work (theoretical and empirical) on such matters.

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with IASB.

Part II: Literature Review

Chapter 3

The Agency Theory Model and MGR's Reaction to New Accounting Disclosure and Measurement Standards

3.1. Introduction

The aim of the present chapter is to review the literature relevant to agency theory and the attitudes of firms' MGRs towards new standards regulating accounting disclosure and measurement. Given a wide scope of discretion, agents (MGRs) might choose the best alternative accounting measurement and disclosure to improve their own personal welfare. Actions taken by MGRs might or might not be in the interests of principals (shareholders). To limit agents' discretion, standard-setting bodies have introduced standards regulating disclosure and measurement. Thus, agency theory is relevant to the introduction of regulatory disclosure and measurement standards.

First, adequate disclosure, by means of regulation, improves transparency in financial reporting that enable outsiders (providers of funds) to observe MGR's actions and to have better financial information, which can help, make useful economic decisions.
Second, the implementation of measurement standards limits MGR's discretion in manipulating the financial results of the business enterprise and hence reduces agency problems.

In general, accounting standards are issued to regulate the financial reporting process. More specifically, new or proposed accounting standards are used as control measures to limit preparers' discretion in financial reporting and thus mitigate any conflict of interest between those who prepare the financial statements of an enterprise and those who receive them (shareholders and other users). In other words, one function of financial reporting is to monitor firms' MGRs as to where they act in the interest of providers of funds (Jensen and Meckling, 1976). In the present chapter, agency theory (AT) is used to identify and explain agency relationships in the firm; where the reaction of the firm's MGR to new and proposed accounting standards is assumed to be based on self-interest. Positive accounting theory attempts to research those factors influencing the attitudes of MGRs towards new and proposed accounting standards.

The remainder of this chapter is set out as follows:
Section 2 discusses agent problems that are considered in the agency literature. Section 3 presents the main factors that determine the reactions of firms' MGRs to new accounting regulations. Section 4 focuses on the effect of the variables on the implementation of accounting disclosure standards. Factors influencing the attitudes of firms' MGRs toward accounting measurement standards are identified in section 5. Section 6 provides summary and concluding remarks.

3.2 Agency theory Model (AT)

Delegation of decision-making authority is the most important feature of the modern business enterprise. Owners of the business delegate authority to professionals. According to Jensen and Meckling (1976, p., 309):

> An agency relationship is defined as a contract under which one or more persons [(principal(s)] engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent.

Thus, such delegation might give rise to conflict of interest between agents and principals. As discussed in the existing economic literature, AT focuses on the relationship between a single principal (shareholder) who provides capital and consequently possesses a claim on the value of the firm and an agent (MGR) whose efforts are needed to improve the market value of the firm. As noted in the finance literature, AT also deals with the relationships of different groups of principals (e.g. shareholders and lenders).

The economic and financial analyses of AT are based on two fundamental assumptions (Barnea et. al. 1986, pp. 25-26).

1. All individuals are assumed to choose actions that maximize their own personal welfare. As a consequence, principals delegate decision-making authority to agents, and the latter use this power to improve their own personal welfare. Actions chosen by the latter to achieve this goal might or might not be in the interest of the former.
2. Individuals are assumed to be rational and capable of forming unbiased expectations relating to the impact of agency problems and the associated future value of their wealth.

There are three types of agency problems that are considered in the agency theory literature[18]. These are:

1. Partial ownership of the firm by the owner-MGR might provide an incentive to consume non-pecuniary benefits or perquisites beyond that which a 100% owner would consume.
2. The existence of debt finance under limited liability provides an incentive to shareholders to engage in high-risk projects that transfer wealth from lenders to shareholders. Debt finance under limited liability might motivate shareholders to forgo new profitable investments, which benefit only lenders. Debt finance might also reduce the market value of the firm when disputes between shareholders and lenders are resolved through the process of costly bankruptcy.
3. There is a problem of information asymmetry. The problem emerges when the MGR, assumed to be acting in the interests of existing principals, attempts to attract new capital from outsiders (new providers of capital). The MGR possesses inside information on the future value of the firm, but he cannot convey all the necessary information to the market because of a moral hazard problem.

AT is relevant to the situation of an Islamic bank. For example, the financial statement-preparer is accountable to various categories of investors including IAHs whose returns on their invested funds must be calculated on a profit-and-loss-sharing basis. Islamic profit-and-loss-sharing

[18] For example, see Jensen and Meckling, 1976; Barnea et. al.., 1985 and Archer, et. al., 1998

investment accounts run on the basis of a *Mudaraba* contract. According to a *Mudaraba* contract the IAHs receive their share of the profits or bear their share of the losses, while the bank as *Mudarib* receives a *Mudarib's* share (commission) in the profits generated from the pool of the assets in which the funds are invested. The method of profit calculations involves the allocation of profit or loss on the pool of the assets between shareholders and IAHs. These profit and loss calculations are not observable by IAHs, i.e., information asymmetry (Archer and Karim, 1997, pp. 98-99)

However, Archer, et. al., 1998, p., 155) mentioned that:

> AT is concerned with, among other things, how to develop a proper system of ex ante incentives as well as examining the set of ex ante conditions that produce goal congruence (or reduce the divergence) between the interests of shareholders and those of management through appropriate specification of the employment contract.

The shareholders can protect their interests through the effectiveness of bonding and monitoring covenants to reduce the agency problem. In this regard, Leftwich et. al., 1981, pp., 56-57) pointed out that:

> Of course, the holders of outside capital are aware of the potential agency problems and anticipate the behaviour of agents when they price their claims. Agents have the incentive to devote resources to reduce the divergence between their actual behaviour and that desired by the principal. The principal can constrain and monitor the agents' behaviour and the agents can offer to impose certain restrictions on their own behaviour through bonding arrangements, rather than have holders of outside capital price the claims to reflect all the anticipated divergence.

In other words, the MGR (agent) agrees to enter into 'bonding' arrangements, which bind him to act in the shareholders' interests. Moreover, 'monitoring' arrangements such as periodic financial statements permit shareholders to observe MGR's actions or to check whether 'bonding' arrangements are being followed.

It can be stated that there is an issue of the users' right to be provided with the information in financial statements and notes. In practice, users' rights to access information need to be balanced against preparers' (agents) desire for privacy (Ijiri, 1975). If the preparer restricts monitoring arrangement on the grounds of privacy, he must accept the potential residual loss in the market value of the firm.

The role of accounting standards and auditing as monitoring devices is to control MGRs' actions as to whether they act in the interests of the provider of funds. Watts and Zimmerman (1986) cited some examples of the role of accounting and auditing as monitoring arrangements. Lending arrangements between firms' MGRs and their banks (lenders) often require firms to maintain interest coverage ratios above a certain level. This generates demand for accounting earnings to determine whether the interest coverage is met. The EA of the firm contracts with debtholders to report any observed breach of restrictive covenants (e.g., the interest coverage ratio covenant). Audited earnings numbers are also used in a bonus plan. In other words, a MGR (agent) might pay additional costs (bonding costs) to ensure that he will not harm the existing principals or they will be compensated if he does that[19].

3.3 Main factors influencing MGR's reaction to new accounting regulations

3.3.1 Signaling problem

Signaling theory assumes that firms have incentives to disclose information voluntarily to the stock market even if there are no disclosure requirements. This is because they need to raise their capital at low cost. Following Lev (1988), Wolk and Tearney (1997, p., 16) argued that:

> The ability of the firm to raise capital will be improved if the firm has a good reputation with respect to financial reporting. In addition, good reporting would lower a firm's cost of capital because there is less uncertainty about firms that report more extensively and reliably; therefore, there is less investment risk and a lower required rate of return.

A listed company with high profit motivates its MGR to provide greater information because it increases investors' confidence, which in turn, improves its market value (i.e., reduces agency costs of equity) and makes external financing easier and cheaper. Therefore, the market induces

[19] See Jensen and Meckling, (1976), Watts and Zimmerman (1986), Kelly (1983) and Archer and Karim (1997)

all companies with good results to send signals to the market. Moreover, firms whose share prices are undervalued have an incentive to expend additional resources to signal that fact. By contrast, those firms whose share prices are overvalued would implicitly signal that fact by disclosing no additional information (Watts and Zimmerman, 1986, pp. 165-166).

The signaling hypothesis, thus, is that a firm with better financial performance is willing to comply with the stock market's requirements for information. This will reduce information asymmetry between the insiders (preparers) and outsiders (users). By contrast, a firm with poor financial performance is unwilling to comply with market requirements for information which in turn tends to increase information asymmetry between preparers and users of financial statements, and hence prevents a residual loss in the market value of the firm.

Positive accounting research attempts to provide an explanation and prediction of MGR's reaction to new accounting regulations by using various economic variables. The discussion of the following issues draws heavily on Jensen and Meckling (1976), Watts and Zimmerman (1986) and Kelly (1983).

3.3.2 Compensation Plan Model

Jensen and Meckling (1976) assumed that the management of a firm whose MGRs are also part-owners would have an increasing tendency to maximize their own welfare (e.g. amounts of pay and perquisites) at the expense of the welfare of the firm's owners as their proportional ownership decreased. As discussed in the Jensen and Meckling's study (1976), the effectiveness of both bonding and monitoring arrangements would reduce agency costs. MGR's total compensation from firms consists of wages, incentive compensation (cash bonuses and stock or stock option) and non-pecuniary income including perquisites. However, MGR's manipulation of reported earnings would not be entirely restricted, as long as bonding and monitoring measures are costly. Therefore, earnings-based bonus plans can be used to explain and predict MGR's reactions to new accounting standards. This has led researchers [e.g., Watts and Zimmerman (1978) and Dhaliwal (1982)] to hypothesize that, other things being constant, MGRs of firms with bonus plans are unlikely to favour new or proposed accounting standards that reduce reported earnings.

3.3.3 Political Costs Model

Watts and Zimmerman (1986) assumed that like private individuals, politicians and bureaucrats in the political process maximize their utilities. Under this assumption, the political process is described as 'a competition for wealth transfer'. Taxes and regulation have the effect of transferring wealth to individuals via government services, subsidies, protective tariffs and monopolies. The nature of the political process may vary from one society to another. Moreover, politicians may be motivated by high reported earnings to regulate monopolistic firms. For example, as reported in Watts and Zimmerman (1986), the published reported profits influenced politicians and regulators to take actions against firms with high profits (e.g., the US oil industry firms at the time of crisis, 1970 -1974). This has led researchers (e.g. Jensen and Meckling, 1976) to assume that firms with large size (e.g., total assets) are politically more sensitive than firms with small size. Some positive accounting researchers (e.g., Watts Zimmerman, 1978) have used firm's size as proxy for political costs. It is therefore hypothesized that the MGRs of firms with large total assets are more likely to lobby against new or proposed accounting standards that increase reported earnings than MGRs of firms with small total assets. In short, accounting numbers are used to define or govern various agency relationships between interested parties (e.g. agency costs of equity and debt). The incentives provided by the political process (to reduce reported earnings) are in direct opposition to the incentives given by management compensation plans (to increase reporting income).

3.4 MGR's reactions to the implementation of accounting disclosure standards

Cerf (1961) investigated the effect of certain characteristics of firms on the extent of disclosure in financial statements by firms. The most frequent of these characteristics have been firm size and listing status. The methodology used was the disclosure index of 31 weighted items on disclosure in 527 American firms. He postulated that the firm's size (in terms of total assets) and listing status were likely to explain differences in the firms' disclosure frequency. The findings from Cerf's study showed that firm's size (in terms of total assets) and listing status were significantly and positively associated with disclosure frequency.

Singhvi and Dcsai (1971) studied the impact of certain variables on the frequency of disclosure. They hypothesized that the variables mentioned below are likely to explain some variations in the frequency of disclosure in the financial statements of firms in the USA and UK. The independent variables include; 1/ Firm's size (total 1989 revenues), and 2/ Listing status. (NYSE/ASE vs. NASDAQ)

It was found that disclosure frequency was associated with firms' size for both USA and UK accounting disclosures. With regard to listing status, timely disclosures were more frequent on the NYSE/ASE than NASDAQ. As expected, disclosure frequency was positively correlated with firm size and listing status (Singhavi and Desai, 1971, p., 92)). In short, the results from Singhvi and Desai's study indicate that listing status, and firm's size were statistically and significantly associated with the frequency of disclosure.

Leftwich et. al. (1981) investigated cross sectional-variations in the frequency of interim financial reporting by listed firms on the stock exchange. They hypothesized that the firm's asset structure and use of other monitoring measures (e.g. stock exchange's requirements) are likely to explain the difference in disclosure frequency. The independent variables (e,g, firm's size and listing status) were examined in relation to the cross-sectional variations in the frequency of the external financial reporting.

The findings from the Leftwich et. al. (1981) study showed that listing status was the only variable found to be statistically and significantly associated with the frequency of interim reporting. However, Leftwich et al's (1981) study had little success in explaining the cross-sectional variations in the frequency of financial reporting. This was because, overall results were not strong and the study encountered several methodological problems.

Frost and Pownal (1994) investigated the effect of certain variables on the periodic accounting disclosures in the financial statements by USA and UK firms in 1989. This study was based on periodic accounting disclosure of 107 firms. Firms were selected from both the USA (NYSE and ASE) and UK. They hypothesized that firm's size and listing status were likely to be associated with disclosure frequency. The findings from the Frost and Pownal study showed that firm's size (total assets) and listing status were significantly and positively associated with the frequency of disclosure (Frost and Pownal, 1994, pp., 85-100).

The limitation of the above studies (see the summary of findings in table 3.1 below) suggests that other explanatory variables need to be considered, such as information costs. This variable might be used to explain variations in MGRs attitudes towards the new disclosure requirements.

Table 3.1: Summary of the prior studies' findings of disclosure frequency

Author(s)	Independent variables	Results
Cerf (1961)	Listing status	S
,, ,,	Firm's size	S
Singhvi and Desai (1971)	Listing status	S
,, ,,	Firm's size	S
Leftwich et. all (1981)	Total fixed assets/firm value	NS
,, ,,	Listing status	S
Frost and Pownal (1994)	Firm's size (total assets)	S
,, ,,	Listing status	S

S: statistically significant. NS: Not statistically significant.

3.5 MGR's reactions to new and proposed measurement standards

A number of empirical studies were conducted and within each study various independent variables were tested in relation to the attitudes of the firm MGRs towards new or proposed accounting measurement standards. The present section discusses some examples of these studies.

3.5.1 Lobbying positions in the FASB's discussion of General Price Level adjustment

Watts and Zimmerman (1978) argued that the major effects of a general price level adjustment (GPLA) on a firm's reported earnings took place through depreciation and gain and loss on the net monetary assets. In inflationary periods, asset costs on GPLA basis rises, and the GPLA depreciation is larger than the historical cost depreciation, thus reducing the firm's reported income. Net monetary assets are defined as the difference between the firm's monetary assets (e.g. receivables and loans) and its liabilities. Under GPLA, in inflation, if the net monetary assets are positive the firm recognizes a holding loss, and if they are negative the firm recognizes a holding gain.

Accordingly, Watts and Zimmerman (1978) assumed that corporate MGRs lobby only if they expect the benefits of lobbying to exceed the cost. Thus, MGRs of politically sensitive firms are likely to lobby in favour of GPLA, if GPLA reduces reported earnings, while they oppose GPLA, if it would increase their firms' reported earnings. As regard, Watts and Zimmerman (1978) identified the independent variables, which are likely to influence MGR's attitudes towards the proposed accounting measurement standards. The independent variables include:

1. Total assets size as a proxy for political costs.
2. Membership of politically sensitive industry.
3. Bonus plan

Given the proposed accounting measurement standard, MGR's position depended on the size of the firm (the magnitude of the political costs) and whether the proposed accounting standard (GPLA) decreased or increased the firm's reported income. The benefits and costs of the proposed accounting standard were expected to vary with the firm size. The sample size of the study was 53 firms. The position of one firm could not be determined, and 18 were classified as supporting the proposed measurement standard, and 34 were classified as opposing.

The findings of Watts and Zimmerman's (1978) study indicated that firm's size (in terms of total assets and sales revenue) was found as the only statistically significant variable which explained the firms' lobbying position. That is to say, firms with large total assets opposed the proposed standard (GPLA) when income was increased (See Table 3.2 below). The findings of this study confirm the relationship between size and MGR's attitudes toward the GPLA. Hence the most important factor explaining managerial voting behaviour on GPLA is the firm size. However, the test of significance for the bonus plan is found to be statistically insignificant because the GPLA would have no direct effect on the compensation plan.

Table 3.2: The findings of Watts and Zimmerman's study (1978)

Independent variables	GPLA
Firm's size (total assets)	S
Membership of politically sensitive industry	NS
A bonus plan	NS

S: statistically significant. NS: Not statistically significant.

3.5.2 Lobbying positions on the FASB's proposed standard for interest costs

Before the 1933 and 1934 Securities Acts, firms had freedom of choice between capitalization and expensing of interest costs on funds borrowed to construct assets not yet producing revenue. The shift from capitalization to expensing of interest costs would reduce the firms' incomes in the short term. Dhaliwal (1982, pp., 255-265) investigated the lobbying positions on the FASB's discussion memorandum on Statement No. 34 relating to accounting for interest costs.

Large firms (measured by total assets) were predicted to oppose interest capitalization, since higher reported earnings attract the attention of politicians and regulators, thereby resulting in tax, political and regulatory costs to the large firms. Moreover, firms with bonus plans were anticipated to support interest capitalization in so far as higher reported earnings would increase income and bonus.

Dhaliwal's sample was 30 firms opposing capitalization and 14 firms opposing expensing interest costs. Financial data was obtained for 1977, the year of discussion memorandum period of the standard. The results of the Dhaliwal's study showed a statistically insignificant difference for firms' size and bonus plan.

Table 3.3: The findings of Dhaliwal's study (1982)

Independent variables	Lobbying against mandated accounting change
Firm size (total assets)	NS
A bonus plan	NS

S: statistically significant. NS: Not statistically significant

3.5.3 Corporate lobbying and changes in financing or operating activities

Kelly (1982, pp. 153-173) investigated corporate lobbying and changes in financing or operating activities for the FASB's standard on foreign currency translation. The main effect of change from FAS 8 to FAS 52 was to reduce volatility in reported earnings, since currency translation gains/losses were taken directly to equity capital under FAS 52. Agency costs were used to explain MGR's oppositions to the exposure draft of the FAS 52 and subsequent financing and operating decisions. This led Kelly to hypothesize that firm, which lobbied against the standard, would also make financing or operating changes after its passage.

Kelly's sample was 52 U.S firms. 14 firms lobbied against the standard; 16 firms lobbied for the standard; whereas 2 firms did not show their positions on the standard. The findings of the Kelly study showed no statistically significant association between MGRs' reactions to the proposed measurement standard and their actions with regard to financing and operating changes. On the other hand, the findings indicated that firms that had greater proportions of incentive compensation, large size (total assets), and lower proportional management ownership undertook lobbying activities. Only firms with large size (total assets) were significantly associated with financing and operating decisions to overcome the impact of the accounting change.

Table 3.4: The findings of Kelly's study (1982)

Independent variables	Lobbing for or against the proposed standard	Financing or operating changes
Total assets	S	S
Incentive compensation/ total management remuneration	S	NS
A bonus plan	S	NS
Management percentage ownership	S	NS

S: statistically significant. NS: Not statistically significant

3.6 Summary and concluding remarks

The analyses of the previous studies did not provide clear conclusions, as they focused on different models, constructs and variables. Explanations for selecting firm's characteristics were examined including agency costs, political costs, information asymmetry, signaling, compensation plan and capital needs. Positive accounting research over the years has examined the determinants of MGRs' reactions to the implementation of regulatory disclosure and accounting measurement standards. A number of empirical studies were conducted and within each study various independent variables were tested in relation to the MGRs' positions towards regulating disclosure in financial reporting and new or proposed accounting measurement standards.

As for regulatory disclosure, the most frequently used independent variables have been firm's size and listing status. For example, firm's size, (as measured by total assets or market value of the firm), was statistically found to be significantly and positively associated with the frequency of disclosure. Listing status was also found to be significantly and positively associated with the frequency of disclosure (e.g. Leftwich, Watts and Zimmerman's (1981)). With regard to new and proposed measurement standards the bonus plan variable received a little support (e.g., Watts and Zimmerman, 1978, Dhaliwal, 1982 and Kelly, 1982). Total assets and membership of a politically sensitive industry as proxy for political costs produced modest support (e.g., Watts and Zimmerman, 1978, Dhaliwal, 1982 and Kelly, 1982). The limitations of the findings suggest other independent variables such as information costs, which might be used to explain variations in the MGRs' attitudes towards, and opinions on, new set of regulatory standards.

As mentioned in chapter 2 above, the implementation of new accounting standards would attract the attention of preparers of financial statements (e.g., MGRs). Nevertheless, the implementation of AAOIFi's accounting standards raises a number of issues similar to those raised by the existing accounting literature in Western countries where listed and unregulated firms operate. These issues include the reception of the standards by financial statements preparers, whose attitudes may have an important bearing on the success of the implementation. It is the purpose of this thesis to examine preparers' opinions about, and compliance with AAOIFI's accounting standards in Sudan where publicly-owned and regulated banks operate. In the light of previous academic work (theoretical and empirical) on such matters, but also taking into account the institutional and cultural differences between Sudan and developed Western countries to which this previous work relates.

Chapter 4

The Evaluation of Audit Risk by External Auditors

4.1 Introduction

The aim of this chapter is to examine the research literature on factors influencing the evaluation of the implications of the audit risk and business risk. The limited literature on auditors' evaluation of the implications for the risk associated with the application of new accounting standards has led the researcher to use an indirect approach. The indirect approach includes literature on types of conventional audit risk and business risk and factors influencing the evaluation of such risks by EAs. The approach is based on the assumption that the normative audit risk and business risk are used to measure the actual evaluation of the implications of audit risk by the EA. Hence, it may be used to formulate theoretical propositions relating to EA's opinions on, and attitudes towards, the evaluation of the implications for the risk associated with the implementation of AAOIFI accounting standards.

In a normative way, EAs have been asked to evaluate the elements of the audit risk and risk implication for audit practices in response to increasing risk that a client's financial statements would contain material misstatements. Misstatements, however, can arise from either of two sources; errors [i.e., unintentional misstatements] or irregularities [i.e., intentional misstatements]. On the other hand, EAs respond to the evaluation of the business risk – the auditor's business risk is the risk of damage to the auditor's professional practice (e.g. litigation and reputation) due to client's business risk.

The remainder of this chapter is organised as follows:
Section 2 defines the audit risk model (ARM) and business risk. Section 3 compares and contrasts audit risk to business risk. Related literature on factors influencing the evaluation of the implications of normative audit risk and business risk is examined in section 4. Section 5 provides a summary and concluding remarks.

4.2 Definitions of the audit risk and business risk

4.2.1 The audit risk model (ARM)

According to the Statement of Auditing Standard (SAS) 300, audit risk is defined as 'the risk that the auditors may give an inappropriate opinion on financial statements" (Scannell, (1998, p., 42). In other words, the auditee's assertions[20] may contain material misstatements exceeding tolerable error at the end of the audit, and an invalid conclusion may be drawn from those assertions (Professional standards, AICPA, AU). Thus, an inappropriate opinion will be given on the financial statements, because of an undetected, undisclosed material misstatement due to error, fraud or irregularities. Statement of Auditing Standard No. 47 (AICPA, 1997a) requires auditors to use the ARM as part of the audit planning process. The presentation of the ARM, including variable definitions, is given in Appendix 3 below.

4.2.2 Business risk

The business risk is the risk that an entity's business objectives will not be achieved as a result of the external and internal factors, pressures and forces that are brought to bear on the entity and, ultimately, the risk associated with the entity's survival and profitability. More specifically, the auditor's business risk is defined as: "the risk of loss or injury to an auditor's professional practice due to client relationships" (Houston, et al., 1999, p.282).

Business risk occurs at two levels, namely:
At client or auditee level: business risk includes commercial risk and fiduciary (litigation) risk. It should be noted that business risk, which occurs at the auditee level, is outside the scope of the present study.

At audit firm level: business risk includes litigation risk and reputation risk. The litigation risk arises because shareholders or creditors might incur a loss large enough to motivate them to bring a lawsuit against EAs (e.g. Pratt and Stice, 1994). The reputation risk arises if an EA is found to be less competent and independent than expected, the audit firm's reputation is damaged and the present value of the auditor's service is reduced (Watts and Zimmerman, 1986, pp., 315-1).

[20] Professional standards state five assertions relating to each account. These are completeness, existence accuracy, valuation and ownership.

4.3 Comparison between audit risk and business risk

Based on the definition of the ARM, the model is concerned with the risks associated with issuing unqualified opinions on a client's financial statements that contain material misstatements. Business risk is concerned with risk that arises if an auditor makes a negligent statement, so that he or she may be liable to shareholders or creditors. The primary costs associated with business risk relate to litigation and reputation risk, namely whether the exposure leads to auditors being held liable for a client's shareholders' losses (Houston, et al., 1999). Business risk, therefore, includes additional factors over and above the audit risk associated with issuing unqualified opinions on materially misstated financial statements.

4.4 Factors influencing the evaluation of audit risk and business risk

4.4.1 Factors affecting the evaluation of audit risk

Scannell (1998) identified some factors that tend to influence the evaluation of audit risk. These factors include:

a. Nature of client's business:

A Company may operate in a highly competitive industry. This would place a pressure on staff to make sales to customers with high credit risks, and would also affect the pricing policy with implications for inventory valuation. For these reasons an auditor will have to carry out additional audit work in relation to receivables in order to reduce collectibility risk. Thus, it is assumed that the size of receivables is likely to affect the evaluation of the implication of audit risk associated with collectibility of receivables.

b. Numerous locations:

Scannell (1998) pointed out that a major problem with branches is their control. Auditors would have to consider the number of branches and their location. The auditors should ensure that the information kept at the branches is adequate for audit purposes. She argued that the number of locations presents a risk to the auditor, as it is unlikely the auditor would be able to visit all branches and therefore, he or she needs to rely on returns from branches. Therefore, it might be assumed that the number of branches will increase the audit risk associated with issuing unqualified opinions on financial statements that contain material misstatements.

Hence, large number of branches may have an effect on the evaluation of the implications of audit risk by EAs.

4.4.2 Factors that influence the assessment of business risk

Pratt and Stice (1994) investigated the effect of the client's characteristics on the EAs' evaluation of business risk and recommendations for more audit evidence and more fees. They identified five independent variables, (a) client's financial condition, (b) asset structure (levels of accounts receivable and inventory to value of total assets), (c) sales growth, (d) market value of equity, and (e) variability in stock price performance. They also identified five dependent variables, (i) probability of an audit failure, (ii) capital provider losses, (iii) audit evidence required, and (iv) audit fee.

As for asset structure [debtors and inventories] variable, the results indicated that the proportion of receivables to total assets would relate positively to a high level of audit risk and a need for more audit evidence and fees. In other words, clients with high proportion of receivables to total assets were more risky to audit and consequently more audit fees were required (Pratt and Stice, 1994, p., 640).

4.5 Summary and concluding remarks

The audit risk model is designed to help EAs to manage risks associated with issuing an unqualified opinion on financial statements that contain undetected material misstatements. Nevertheless, business risk encompasses additional factors that are not explicitly reflected in the ARM.

Scannell (1998) identified some factors to evaluate the implications of audit risk. These factors include nature of client's business and numerous locations. Scannell's study provided no empirical results on factors influencing the evaluation of audit risk by EAs.

Pratt and Stice (1994) investigated the effect of client characteristics on the evaluation of the business risk, the level of audit evidence and fees required. The findings indicated that clients with high proportion of receivables to total assets were more risky to audit. Consequently, more audit evidence and fees are required. This suggests that the client's collectibility of receivables policy is a primary consideration in the EA's actual evaluation of audit risk and in recommendations for additional audit evidence and fees required.

The empirical testing of theoretical propositions derived from the normative business risk provides justification for their use in the present study, as a source of propositions about auditors' opinions on, and attitudes towards, the evaluation of the audit risk associated with the application of new accounting standards. On the other hand, environmental differences (namely culture and institutional differences), between the USA from which most theories on auditing are borrowed and Sudan to which these theories might be applied in present thesis, have implications for most of the literature reviewed and thereby on Islamic auditing. In particular, Sudanese banks belong to a largely nationalised and regulated banking industry that may be risky and expensive to audit.

Part III: Research Methodology and Methods of Data Analysis

CHAPTER 5

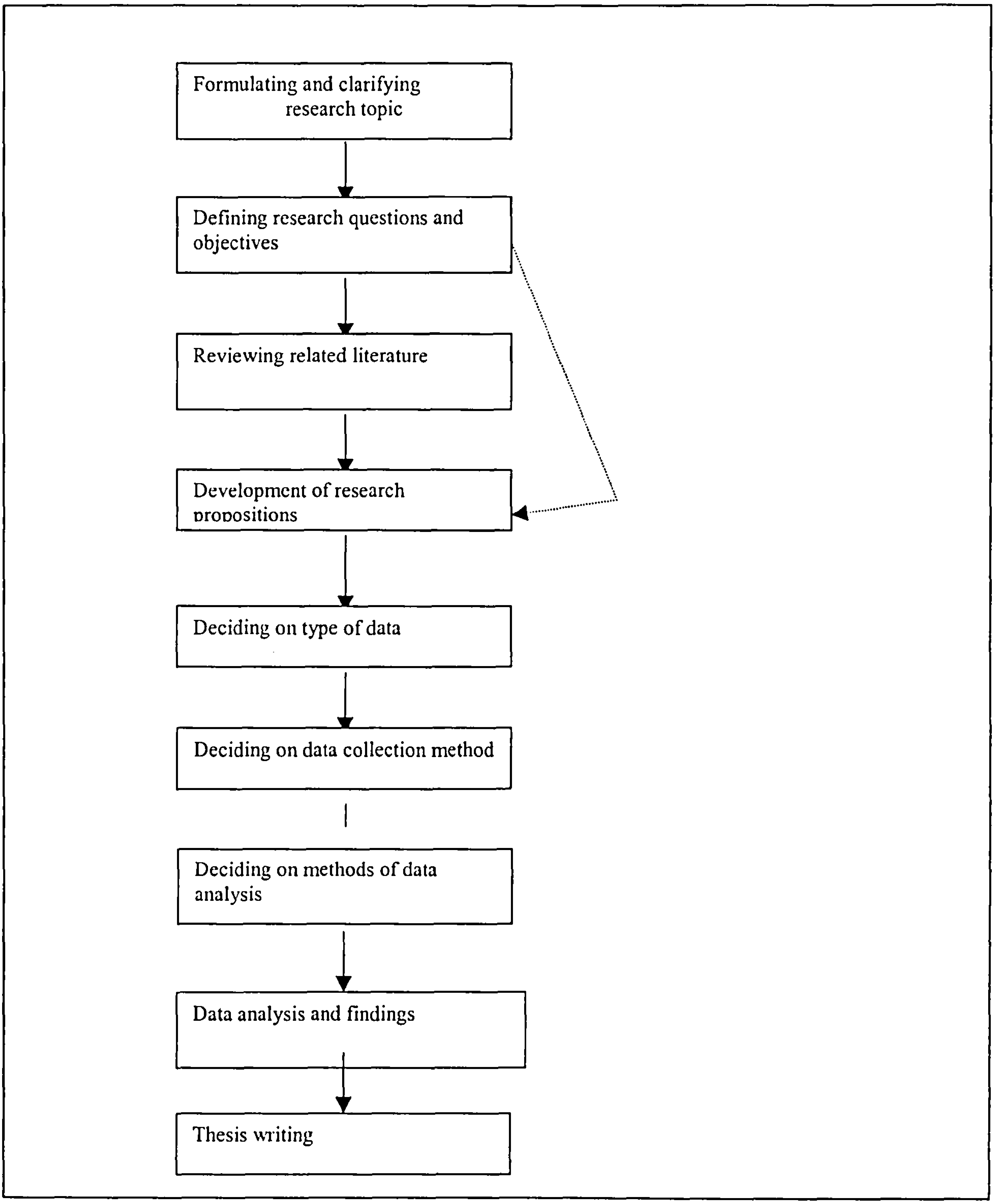
Research Methodology

5.1 Introduction

As already mentioned in chapter 1, attitudes of preparers of financial statements toward new accounting standards have received much attention in the accounting research literature. This attention has mostly been in Western countries. With regard to the distinction and relationship between attitudes and opinions, it might be argued that attitudes have a reference to the respondents' views or feelings toward a phenomenon, whilst opinions are the verbal expression of such attitudes (Clark et al, 1998, p.:117). However, individuals' expressions of opinions may be treated as indicators of attitudes, and this is very common in accounting research (for more details see section 6.2 in Chapter 6 below). This study elicits respondents' attitudes towards, and opinions about, the implementation of new accounting standards. A major interest of the present study is that it examines the issues in question in the setting of an emerging market economy, namely that of Sudan. The study also considers the opinions of EAs on the implementation of new accounting standards, an important topic on which there appears to be relatively little research literature. The present chapter discusses the research methodology used in this study of preparers' and auditors' attitudes towards opinions on, and, the implementation of the new accounting standards issued by the AAOIFI.

Most textbooks (e.g. Saunders et al. 2000) describe research as a multi-stage process that ought to be followed in order to carry out and complete a research project. The precise number of research stages does vary considerably. However, these usually include formulating and clarifying the research topic, reviewing the related literature, selecting a research method, collecting data, analyzing data and writing up the thesis report (Saunders et al. 2000, p. 4). This study is based on a research process, which is presented in a book on research methods for business students (Saunders et al. 2000). What is described in the present chapter and the next one is a series of inter-linked stages, which led the researcher to finalize his research questions and to design the necessary research instrument (,See Figure 5 below, which provides an overall description of the research design).

Figure 5: The design of the present research



Source: Author

The remainder of this chapter is divided as follows:

Section 2 defines the research questions and objectives. Section 3 provides the research design. Section 4 summaries reviews of related literature. Section 5 develops theoretical propositions regarding opinions of the bank MGRs and EAs about the implementation of AAOIFI's accounting standards. Summary and concluding remarks are provided in section 6.

5.2 The research questions and objectives

Saunders et al (2000) stated that: "before you start your research you need to have at least some idea of what you want to do". They added that without clarity on what you are going to research, it is difficult to plan how you are going to research it (Saunders et al. 2000, p. 12). Accordingly, identifying and clarifying a research topic is the starting point in undertaking a research project.

Initially, this researcher started his research with the topic about the potential problems of implementing AAOIFI's accounting standards (hereafter referred to as accounting standards) in Islamic banks in Sudan. After consultation with the supervisors of this thesis, the researcher decided to amend the topic to explore the relationship between the characteristics of an Islamic bank (e.g., ownership) and the opinions of MGRs and EAs about the implementation of accounting standards. The study thus focuses on the opinions of preparers (MGRs) and EAs about the implementation of the accounting standards (as a new phenomenon) within the context of Islamic banks in Sudan.

5.2.1 The research questions

The topic of this study having been identified, it follows that research questions have to be addressed. Saunders et al. (2000) argued that it is often an important starting point in defining questions to begin with one general focus research question. The general question flows from the basic research ideas. This may lead to several more detailed questions.

As mentioned above, the topic is concerned with MGR's and EA's attitudes towards, and opinions on, the implementation of accounting standards. Therefore, the following general questions need to be addressed and investigated (See Table 5.1 below).

- To what extent do MGRs display positive or negative attitudes towards, and opinions on, the implementation of the accounting standards and why?
- How do Islamic banks differ in their actual implementation of AAOIFI's accounting standards and why?
- How do EAs evaluate the implications for audit risk associated with the implementation of AAOIFI's accounting standards and why?
- What are the main findings of the research that could be addressed in future research?

5.2.2 The research objectives

Having formulated the overall research questions, what follows defines the general objectives of this study, which are:

1. To examine MGRs' attitudes towards, and opinions about, the implementation of accounting standards.
2. To compare and contrast the implementation of accounting standards in a number of Islamic banks in Sudan.
3. To examine EAs' evaluation of the implications for audit risk associated with the implementation of accounting standards.
4. To explore issues relating to the findings of the research, which could be addressed in future research.

Table 5.1 Phrasing research questions as research objectives

Research questions	Research objectives
1- How much do MGRs agree or disagree in their attitudes towards, and their opinions on the implementation of the accounting standards and why?	1. To examine MGRs' attitudes towards and opinions about the implementation of the accounting standards. 1-a To identify variables, which influence MGRs' attitudes towards, and opinions about,, the implementation of the disclosure standard. 1-b To identify variabless, which influence MGRs' attitudes to, and opinions about, the implementation of the measurement standards.
2- How do banks differ in their actual compliance with the accounting standards and why?	2-a To compare and contrast the implementation of the accounting standards in a number of Islamic banks in Sudan. 2-b To identify variables, which affect the banks' actual compliance with the accounting standards.
3- How do EAs evaluate the implications for audit risk associated with the implementation of the accounting standards and why?	3a- To examine EAs' evaluation of the implications for audit risk associated with the implementation of the accounting standards. 3b- To identify variables, which influence EAs' evaluation of the implications for audit risk associated with the implementation of the accounting standards.
4- What are the main findings of the research that could be addressed in future research?	4- To explore issues relating to the findings of the research, which could be addressed in future research

5.3 Research design

Aaker et al (1998, p.73) defined research design as " a detailed blueprint used to guide a research study towards its objectives and this involves a number of interrelated decisions". Moreover, Yin (1994, p.19) stated that research design is a logical sequence that connects empirical data to its initial study questions, and ultimately, to its conclusions. Sekaran (2000, p.121) mentioned that research design entails a series of rational decision-making choices. The most important one is to make a decision on the choice of the research strategy; that is, to determine how the research objectives are to be achieved.

Research strategy

In order to select an appropriate strategy for the present research study, the researcher examined possible alternative research strategies. There are several strategies for doing social science research, which include case studies, experiments, surveys, histories and analyses of archival information. Each strategy involves a different way of collecting and analyzing empirical evidence (Yin, 1994, p. 3). The use of each strategy depends upon three conditions: (1) the type of research question, (2) whether an investigator has control over actual behavioural events, and (3) whether the focus is on contemporary as compared to historical phenomena. The importance of each of the three conditions, in distinguishing among the aforementioned five strategies, is examined below.

Yin (1994) pointed out that some types of "what" questions might either be exploratory (in an exploratory study any type of the five research strategies can be used) or about the prevalence of a phenomenon (in which a survey or the analysis of archival records would be appropriate). The second type of "what" question would be a form of a "how many" or "how much" line of inquiry. For instance a survey can be carried out to enumerate the "how many," whereas a case study would not be the preferred strategy in this situation. He then added that "how" and "why" questions are likely to favour the use of case studies, experiments or histories. For example, if the investigator wants to know "how" a community successfully thwarted a proposed highway he might be better off using a case study or a history (Yin, 1994, p. 6). 'How" and "why" can be studied by either a case study or a survey. Yin (1994) further stated that if "how" and "why" questions are the focus of the study, a further distinction among case studies, experiments and histories can be made. That is the extent of investigators' control over behavioural events and whether the degree of focus is on contemporary issues. He also mentioned that histories are the preferred strategy when there is virtually no access or control. He stressed that the case study is the preferred method in examining contemporary events, when the relevant behaviour cannot be manipulated. In contrast, experiments are performed when an investigator can manipulate behaviour directly. It can also be argued that the case study approach depends on many of the same techniques as those of history. However, it provides additional sources of evidential information from participant-observation and systematic interviewing. Case studies are typically based on two or more methods of data collection. The use of multiple sources of evidence allows case studies to present more rounded and complete accounts of social issues and processes. Whether the case study is descriptive or explanatory, the use of multiple sources of evidence (e.g. in-depth interview, large-scale structured survey, participant and non- participant observation makes the case study one of the most powerful research designs.

In short, the case study can be used when "how" and "why" questions are being asked about contemporary events over which a researcher has no control. However, more than one strategy can be used in any given study (e.g. a survey within a case study). In the light of the above discussion, preparers' and EAs' attitudes towards, and opinions on, the implementation of AAOIFI accounting standards can be addressed by a survey within a case study approach, as described in Chapter 6 below.

The case study is a separate research strategy that has its own research designs. Yin (1994, pp.38-51) cited four types of designs that are relevant for case studies, namely;

(a) single case (holistic) designs
(b) single case (embedded) designs
(c) multiple case (holistic) designs and
(d) multiple case (embedded) designs.

For a single case study, a holistic approach involves a single unit of analysis, (i.e., if the study examines the nature of the whole organization, a holistic case study design is used). A single case (embedded) design involves multiple sub-units of analysis within a single unit. As for multiple case studies, a holistic approach involves a number of single units of analysis, and embedded case studies involve multiple sub-units within multiple units of analysis. The difference between the two designs resides in the type of phenomenon being studied. When an embedded design is used, each individual case study may involve the collection and analysis of quantitative data. Thus, a survey may be used within a case study (i.e. structured questionnaire-based survey within case study (Yin, 1994, p. 51)).

The decision as to which of these to select depends upon (a) the reasons for the choice of the research topic and (b) how much the researcher might wish to generalize from a particular case study (Clark et al, 1998, p.108). These questions need to be considered seriously. Yin (1994, p. 30) emphasized that case studies are generalizable to theoretical propositions. Moreover, Hakin (1987, p. 42) observed that:

At the most rigorous level, case studies are designed to achieve experimental isolation of selected social factors or processes within a real life context so as to provide strong tests of prevailing explanations and ideas.

Therefore, it is necessary to have an adequate theoretical framework to permit testing and making generalizations about theoretical propositions (See Section 5.5 below).

Indeed, evidence and theoretical conclusions drawn from a multiple case study might prove to be far more powerful. However, the objective of a study may be to investigate a 'one-off' situation. The single case study thus becomes an appropriate design under the following circumstances (Yin, 1994, pp. 38-49):

1- When the single case represents the critical case in testing a well-formulated theory.
2- When an investigator has an opportunity to observe and analyze a phenomenon previously inaccessible to scientific investigation.
3- When the case represents an extreme or unique case.

The present study employs a case study approach, using Sudan as a single (embedded) case study design. The reasons for this are as follows:

1- Sudan represents a critical case in testing whether the theoretical propositions (frameworks) developed in Western countries can help explain the accounting phenomenon in the context of a developing market economy.
2- A research opportunity is provided by the introduction of a set of new accounting standards (AAOIFI's accounting standards) in a developing market economy like Sudan, where a substantial degree of state ownership exists.
3- Sudan is the only country with both state-owned and privately owned banks in which all banks operate according to Islamic Shari'a rules and principles.
4- Using Sudan as a single case (embedded) study permits an in-depth investigation when compared to using a survey including another country that had adopted AAOIFI accounting standards (e.g. Bahrain).

These are the main reasons, which make Sudan scientifically interesting as a single case. The reasons for using an embedded case study design are that individual banks and audit firms in Sudan present themselves as appropriate sub-units of analysis for the purpose of this research (See also Chapter 6 Section 6.6 below).

A research study may be cross-sectional or longitudinal. The research study may be cross-sectional (i.e. the study of particular phenomenon at a particular time). This is because most research studies undertaken for academic courses are necessarily time consuming. However, the main strength of longitudinal research study is the capacity that it has to study change and development. Due to time and budget constrains, the present research study will be cross-sectional, the focus being on the opinions and attitudes of MGRs and EAs towards the implementation of accounting standards at a particular time.

As mentioned earlier, a major interest of this study is to see to what extent the independent variables, advanced in well-developed market economies (e.g. USA), are useful in explaining the opinions of managers and auditors about new accounting standards in Sudan. Yet, due to the different environment (e.g. institutional differences) between the USA and Sudan, the independent variables derived from Western accounting literature might not have the same explanatory power in Sudan, as they do in the USA.. Hence, the theoretical propositions 1 through 7, which are developed in section 5.5 below, need to be further investigated; identifying the important features of the country, where regulated and nationalized Islamic banks operate, developing an understanding of them, and conceptualizing them for further research.

5.4 Review of related literature

According to Saunders et al. (2000, p.44):

A critical literature review will form the foundation on which the research study is built. The main purpose of a literature review is to help the researcher to develop a good understanding of relevant prior research, as well as to gain insight into emerging trends. The relevant literature was reviewed with the aim of summarizing the main findings of the previous research literature. The main sources of the literature review were books and periodical journals. For this study, the research literature was reviewed in chapter 3 and 4 above, and examined the following:

1. MGRs' attitudes towards the regulatory disclosure (e.g. accounting disclosure standards).
2. MGRs' attitudes towards accounting measurement standards.
3. EAs' attitudes towards the actual evaluation of the Audit Risk (ARM) and business risk.

5.4.1 Regulatory disclosure

As noted in chapter 3 above, positive accounting researchers (e.g. Watts and Zimmerman 1986, and Kelly 1993) attempted to explain and predict the behaviour of MGR towards regulatory disclosure. The most important independent variables have been firm's size, and listing status. Firm's size, as measured by the value of total assets, firm's market value, or sales, has been found to be significantly and positively associated with MGRs' attitudes toward the level of disclosure (e.g. Frost and Pownal (1994). Size variable has been used as proxy for political costs[21]. As for, listing status, as used to represent capital needs, this was found to be significantly and positively associated with MGRs' attitudes towards the implementation of regulatory disclosure requirements (e.g. Leftwich, 1981, Frost and Pownal, 1994).

[21] Watts and Zimmerman (1986, pp. 251-252) cited four variables that are used as proxies for political costs. These are size, risk, capital intensity and industry concentration

5.4.2 Accounting measurement standards

As noted in chapter 3 above, positive accounting researchers explain and predict MGRs' attitudes towards measurement standards. The most important independent variables are bonus plan and the firm's size in terms of value of total assets. With respect to the bonus plan variable, some prior studies showed that it was found to be significantly associated with MGRs' attitudes towards accounting measurement standards (e.g., Watts and Zimmerman 1978). As for firm's size (value of total assets) as a proxy for political costs, previous studies indicated that firm's size was found to be significantly positively associated with MGRs' attitudes towards the measurement standards (e.g. Watts and Zimmerman, 1978 and Kelly, 1982).

5.4.3 The actual evaluation of the ARM and business risk

As explained in chapter 4 above, there is a lack of research literature on EAs' attitudes towards the assessment of audit risk associated with new accounting standards. For this reason, models from the normative professional literature on auditing were used in order to formulate some theoretical propositions. These propositions concern the evaluation of audit risk associated with the implementation of the accounting standards. More specifically, the normative professional literature on the audit risk (ARM) and business risk was examined in this study. In regard to the ARM, the normative professional literature on auditing is based on the assumption that some variables are likely to influence the assessment of audit risk by EAs. The most important independent variables are the size of receivables to total assets, rapid growth in business and numerous locations, but prior studies have provided no empirical results. As for business risk (e.g., litigation risk), prior research is based on the assumption that a client's characteristics are likely to influence the auditors' evaluation of the implications for business risk. The most important factor is the proportion of receivables to the value of total assets. The proportion of receivables variable is found to be significantly and positively associated with the assessment of the implications for the business risk (e.g., Pratt and Stice 1994). The empirical testing of theoretical propositions derived from the business risk provides justification for its use in this research study, as a source of propositions about EAs' opinions on the implementation of the accounting standards.

5.5 Development of theoretical propositions

Having reviewed related literature, what follows is the formulation of the theoretical propositions relating to the implementation of a new set of accounting standards by Islamic banks. This research study seeks to examine an Islamic bank's characteristics as independent variables (See Table 5.2 below) that would be helpful to explain variations in opinions of MGRs and EAs about the implementation of the accounting standards. The study did not include the religious beliefs of the respondents as an independent variable. The reason for this is that all respondents were Muslims and belong to *Maliki* school of thought, and hence this variable as such, would not be helpful in explaining variations between MGRs or EAs in their attitudes towards and opinions on, the implementation of the accounting standards. A study seeking to examine the role of religious belief in respondents' attitudes towards, and opinions on, compliance with AAOIFI's accounting standards would have been a different study and would have had to develop some measures of respondents' concepts of religious duty.

A crucial issue that needs to be considered in this study is that the difference in institutional context between Sudan (where MGRs work in regulated and in some cases publicly-owned banks) and the context in which the theoretical propositions are based, namely on data about listed, unregulated general trading firms in the USA. Specifically, the macro economic structure in Sudan is characterized by a mixed market economy, where publicly and privately owned banks operate and the role of the state in the national economy is significant. Moreover, Islamic banks operate using financial instruments and *Shari'a* compliant transactions, which are categorically different from those used by conventional banks. These bring about the need for AAOIFI's accounting standards to regulate financial reporting. Another major difference is that the study examines issues in the setting of an emerging market economy, as exemplified by the role of the KSE. Due to these differences, the theoretical propositions advanced in Western countries (e.g., USA), need to be reformulated in order to cope with the specificities of the banking sector in Sudan.

The theoretical propositions are thus based on the main findings of prior research literature, as well as by referring to AAOIFI's accounting standards (FAS1, 2, 3, 4, 6 and 7). These propositions regarding attitudes and opinions of MGRs and EAs about the implementation of the accounting standards are as follows:

- Propositions 1-2 concern MGRs' attitudes towards, and opinions about, the implementation of the disclosure standard and relate to question 2 in section A (see Appendix 4 below).
- Propositions 3-5 concern MGRs' attitudes towards, and opinions about, the implementation of AAOIFI's measurement standards and relate to questions 2 in section B1-B5 (see Appendices 5-9 below).
- Propositions 6-7 deal with EAs' evaluation of the implications for audit risk associated with the implementation of AAOIFI's accounting standards and relate to question2 in section C (see Appendix 10 below).

5.5.1 MGRs' attitudes toward, and opinions about, the implementation of the disclosure standard

Proposition 1

Cost of compliance proposition

Intuitively, the implementation of a new disclosure standard would entail additional costs on the part of management. The preparation of the firm's financial statements according to new disclosure standards will involve additional workload on the part of the MGRs. Moreover, it creates a demand for training courses for the staff working for the firm. In addition, audit services are required to implement the new disclosure standards. Due to the costs of compliance associated with the requirements of new disclosure standards, the MGTs of the firms will be less receptive to new disclosure standards.

The preparation of an Islamic bank's financial statements, in accordance with AAOIFI's disclosure standard (FAS 1), will thus create additional costs for the bank and it involves additional workload on the part of its management. Moreover, it creates demand for training courses for the staff working for the bank, as well as for audit services to implement the AAOIFI disclosure standard (hereafter referred to as the standard). In other words, the implementation of the standard requires well-trained staff working for these banks at branches, regional and office levels. This means that the bank incurs extra costs for training its staff. The larger the number of branches the higher the costs of compliance with the standard. This implies that the MGRs of banks with a larger number of branches are required to spend more time and effort in implementing the standard than MGRs of banks with a smaller number of branches. It is expected that banks with a larger number of branches will be less receptive to the implementation of the standard. It is therefore, proposed that:

Proposition 1: MGRs of banks with a large number of branches will show less positive attitudes towards, and opinions about, the implementation of the standard than MGRs of banks with a smaller number of branches.

Proposition 2

Listing status proposition

A number of authors (e.g., Lev, 1988 and Wolk and Tearney, 1997) have argued that the ability of the firm to raise capital will be improved if the firm has a good reputation with respect to financial reporting. Moreover, good financial reporting would lower a firm's cost of capital since there is less uncertainty about firms that report more extensively and reliably, and therefore, there is less investment risk and a lower required rate of return. Watts and Zimmerman (1986) assume that firms whose share prices are undervalued have an incentive to expend additional resources to signal that fact. By contrast, firms whose share prices are overvalued would implicitly signal that fact by disclosing no additional information (Watts and Zimmerman, 1986, pp.165-166). Accordingly, firms with good performance send signals to the market. Furthermore, Leftwich et al. (1981) have argued that listed companies are induced by the market to disclose more information in order to raise capital at a lower cost and therefore they would be more receptive to the new detailed disclosure standards.

In fact, the government has sole ownership of the equity capital of public banks in Sudan. As a result, these banks have no opportunity to raise equity capital through the KSE[22]. However, private banks are actively traded on the KSE and seek to raise new capital and thus need to consider the secondary market and the behaviour of its share prices. It is expected that MGRs of

[22] Semi-public banks are mostly owned (i.e. more than 50% of their shares) by the state and thus these banks have less opportunity to raise equity capital through the KSE.

banks that are listed on the KSE will have an incentive to disclose more information to the market, since they can raise capital there. It is therefore, proposed that:

Proposition 2: In order to raise funds in the KSE, MGRs of listed banks will show a more positive attitudes towards, and opinions on, the implementation of the standard than the MGRs of non- listed banks.

From the discussion of the cost of compliance proposition (P1) and the listing status proposition (P2), it can be seen that MGRs of banks with larger number of branches are expected to be less receptive, while MGRs of listed banks on the secondary market are expected to be more receptive to the implementation of AAOIFI disclosure standard.

5.5.2 MGRs' attitudes towards, and opinions about, the implementation of the measurement standards

Proposition 3

Bonus plan proposition

Watts and Zimmerman (1986) argued that MGRs' manipulation of reported earnings would not be entirely restricted as long as controlling and monitoring measures by shareholders are costly. It is therefore, expected that MGR can adjust reported income through using alternative accounting measurement procedures in order to increase its compensation. A bonus plan variable, as a measure for compensation, was used to explain firms' cross-sectional variations in attitudes towards the implementation of the measurement standards. Bonus plans provide MGRs with incentives to use or lobby for the use of accounting measurement standards that increase reported income (e.g., Hagerman and Zmijewski (1979) and Dhaliwal (1982)).

Given the limitations of a wide scope of discretion in accounting choices, MGRs of firms with bonus plans resist new measurement standards that decrease reported earnings and/or they lobby for (against) proposed measurement standards that increase (decrease) reported earnings. The implementation of AAOIFI's measurement standards (the standards) would limit MGR's discretion in using alternative accounting treatments. Accordingly, MGRs of banks with bonus plans are expected to be less receptive to the implementation of the standards, since they would have an incentive to increase their compensation through using alternative accounting treatments resulting from the standards. It is thus, proposed that:

Proposition 3: MGRs of banks with bonus plans will show less positive attitudes towards, and opinions on, the implementation of the measurement standards than MGRs of banks with no bonus plans.

Proposition 4

Bank ownership (private-public) proposition

Kelly (1983) and Watts and Zimmerman (1986) explain that political costs arise from both direct and indirect regulation of the firm. In general, MGRs of politically sensitive firms believe that high reported earnings imply abnormal returns, increasing the chance of government action. Specifically, government intervention is related to the firm's membership of a politically sensitive industry. For instance, in the oil and gas industry, windfall profit, combined with the national goal to find alternative energy sources, motivated the US government to enact higher taxes on that industry. Given a wide scope of discretion in measurement accounting standards, a firm's membership of a politically sensitive industry would have an incentive to use accounting procedures that reduce reported earnings. However, the limitation on accounting measurement choices influences MGRs' attitudes towards new measurement standards and their lobbying for the proposed measurement standards that reduce reported income.

The government in Sudan could ask the banking sector, in particular the state-owned banks to provide risky *Salam* facilities to agriculture. As in the case of firm membership in a politically sensitive industry, public banks expect that a high reported income would increase the chance of government intervention, because the government requires public banks with high profitability to invest in high risk projects, such as *Salam* finance to agriculture[23]. Given choices in accounting treatments, public banks would have an incentive to use accounting treatments that reduce reported income. Yet, the implementation of the measurement standards limits the choices in accounting treatments and therefore public banks are expected to be less receptive to such implementation and this is relevant to the political costs theory. It is therefore proposed that:

Proposition 4: MGRs of public banks with high reported income will have a more negative attitude towards, and opinions on, the implementation of the measurement standards than MGRs of private banks with high reported income.

Proposition 5

Bank size variable (total assets) proposition

As mentioned in chapter 3 above, size measured by a firm's total assets can also be used as a proxy for political costs. In this context firms with a larger value of total assets are more politically visible and thus more exposed to the attention of industry regulators. Firms with a larger value of total assets provide government or other regulators with incentives to impose more restrictions on them. Therefore, such firms are expected to use alternative accounting measurement procedures to reduce reported income in order to avoid any sort of restrictions by politician and/or regulators. This makes them sensitive to new accounting measurement standards and induces such firms to resist or lobby against the standards.

[23] There are a number of counter-party risks in the *Salam* contract. These range from failure to supply al-*muslam fihi* (*Al-Muslam fihi* is defined as the commodity to be delivered on *Salam* contract) on time, or even at all, to failure to supply the agreed quality and quantity. Moreover, the counter- party risk in *Salam* does not depend only on factors that are only in the suppliers' own control, but also on factors that are beyond their control, like natural disasters and other reasons for crop failure. Banks may hedge such risks by entering into a parallel *Salam* contract (forward contract) , however any such forward contract must be legally independent of the original contract.

As in the case of other firms with a large value of total assets, Islamic banks with a larger value of total assets are more politically visible and susceptible to government restriction. This provides the government with an incentive to impose additional taxes on profitable banks with a larger value of total assets or to put pressure on them to invest in risky but nationally beneficial projects. Hence, it is expected that MGRs of banks with a large value of total assets will be less receptive to regulatory measurement standards that reduce choices in accounting treatments. It is therefore, proposed that.

Proposition 5: MGRs of banks with a larger value of total assets will show a more negative attitudes towards, and opinions on, implementation of the measurement standards than MGRs of banks with a smaller value of total assets.

Based on the arguments discussed in the ownership proposition, the size proposition and the bonus plan proposition, it can be noted that MGRs of public banks and those of banks with larger value of total assets are expected to be less receptive to regulatory measurement standards. Moreover, MGRs of banks with bonus plans are expected to be less receptive to regulatory measurement standards

5.5.3 EAs' evaluation of the implications for audit risk associated with the implementation of the accounting standards

Proposition 6

***Shari'a* non-compliance risk proposition**

A major objective of auditing financial statements of Islamic banks is to enable the EAs to express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with the rules and principles of Islamic *Shari'a*[24]. However, *Shari'a* compliance would entail a risk of misstatement (intentional or unintentional) on the part of management, specifically, regarding non-disclosure of earnings from *Haram* (non-permitted) transactions. An EA may fail to detect or discover such misstatement.

[24] See AAOIFI, Auditing Standard for Islamic Financial Institutions (ASIFI) No 1, 1996a.

Another type of *Shari'a* compliance risk is the risk associated with *Murabaha* and *Salam*. For example, in the *Murabaha to the Purchase Orderer*, transactions between the parties of the *Murabaha* contract may not be visible to the *Shari'a* supervisor and/or the EA of the bank. Hence, an EA might provide an inappropriate assurance that all *Murabaha* sales are free from non-compliant transactions[25]. In other words, it is a requirement for *Shari'a* compliance that the bank must be the owner of the asset at the time of its sale to the purchase orderer (AAOIFI, 1996a). It is not permissible for the supplier to sell the asset directly to the purchase orderer with the bank merely supplying credit in return for a charge. However, such non-permissible transactions may not be easy to detect by the EA of the Islamic bank. This represents part of the audit risk associated with Islamic *Shari'a* authentication. An EA's evaluation of implications for audit risk associated with *Shari'a* authentication would be higher, as the proportion of *Murabaha* and *Salam* to total assets is greater. It is therefore, proposed that:

Proposition 6: EAs of banks with a larger proportion of *Murabaha* and *Salam* to total assets will consider the implications for the audit risk associated with *Shari'a* non- compliance as being greater than the EAs of Islamic banks with a smaller proportion of *Murabaha* and *Salam*.

Proposition 7

Collectibility of receivables risk proposition

As noted in chapter 4 above, receivables require subjective judgement in determining their values and accordingly, are difficult and risky to audit (Pratt and Stice, 1994). MGR of a company may intentionally or unintentionally overstate or understate receivables, and this would lead to misstatements in the company's financial statements. An EA may fail to detect such misstatement. Similarly, compliance with the accounting standards could entail a risk of misstatement (intentional or unintentional) on the part of management, namely, the risk associated with collectibility of *Murabaha* and *Salam* receivables. In other words, *Murabaha* and *Salam* sales require subjective judgement in determining their values, provision of doubtful debts of *Murabaha* receivables and/or that of estimated deficit of *al-Muslam fihi*[26]. As the

[25] The form of contract of *Murabaha to the Purchase Orderer* involves three parties; the purchase orderer, the bank, and the supplier of the asset.
[26] *Al-Muslam fihi* is defined as the commodity to be delivered.

proportion of *Murabaha* and *Salam* to total assets is high, it is hypothesized that the assessment of the implications for audit risk associated with collectibility of receivables will be greater as long as the proportion of *Murabaha* and *Salam* to total assets is high. It is expected that, the assessment of the implications for the audit risk associated with collectibility of receivables will be high, as the proportion of *Murabaha* and *Salam* to total assets is high. It is therefore proposed that:

Proposition 7: EAs of banks with a higher proportion of *Murabaha* and *Salam* will consider the implications for the audit risk associated with collectibility of receivables as being greater than the EAs of Islamic banks with a smaller proportion of *Murabaha* and *Salam*.

Table 5.2: The relationship between independent and dependent variables

Independent variables:	Dependent variables
1- cost of compliance; number of branches (larger/smaller) 2- Listing status (listed /non-listed)	Bank MGRs' attitudes towards, and opinions on, the implementation of the disclosure standard.
1- Bank size; total assets (larger /smaller) 2- Ownership (public/private) 3- Bonus plan (with bonus/with no bonus)	Bank MGRs' attitudes towards, and opinions on, the implementation of the measurement standards.
1- Level of *Murabaha* and *Salam* to total assets	The assessment of the implications for audit risk associated with *Shari'a* compliance. The assessment of the implications for audit risk associated with collictibility of receivables.

5.6 Summary and concluding remarks

This chapter has focused on the research methodology used in this study. The chapter considered the research process up to the point where the decision on formulating theoretical propositions was made. The topic of the research study was clearly identified; the research questions and objectives were then defined. Sudan was chosen as a critical case in testing whether the theoretical propositions (frameworks) developed in Western countries that can help explain the accounting phenomenon in the context of a developing market economy. Due to the different environment (e.g. institutional differences) in Sudan and USA some of the independent variables might be considered as different from some of those derived from Western accounting literature. Hence, the theoretical propositions 1 through 7 needed to be further investigated, identifying the important features of the country, where regulated and nationalized Islamic banks operate, developing an understanding of them, and conceptualizing them for further research.

CHAPTER 6

Methods of Data Acquisition and Analysis

6.1 Introduction

Having discussed the research process up to the formulation of the theoretical propositions in the previous chapter, what follows deals with the type of data, methods of data acquisition and analysis. The required information plays a very important role in the selection of methods of data acquisition and analysis. It can help identify the sub-units of analysis within the case study, the type of methods of acquiring data to be used and the appropriate methods of analyzing data. As mentioned earlier in the present study, the information required consists of banks' actual compliance, as well as the MGRs' and EAs' opinions on the implementation of the accounting standards in Sudan. The remainder of this chapter is set out as follows:

Section 2 focuses on the type of data. Section 3 points out types of the scale. Measurement techniques are presented in section 4. Section 5 deals with the research instrument. The selection of banks and audit firms is given in section 6. Section 7 describes the conduct of a pilot case study. Section 8 discusses methods of acquiring data. Section 9 presents methods of data analysis. Summary and some concluding remarks are provided in section 10.

6.2 Type of data

Having discussed the research questions and objectives, research design and theoretical propositions in chapter 5 above, the discussion moves to the type of data and methods of data acquisition and analysis.

Attitudes and opinions

As discussed earlier, it is helpful to distinguish between attitude and opinion. The Oxford Dictionary provides a clear distinction between "attitude" and "opinion". "Attitude" is a way of thinking about somebody or something. It comes before behaviour and affects how a person will act. "Opinion" is a belief or judgement about somebody or something, which can be verbally expressed [27]. Moreover, Allport ((1935) as mentioned by Clark et al (1998)) defined an attitude as 'a mental state of readiness, organized through experience, exerting a directive or dynamic influence upon individual's response to all objects and situations to which it is related', (Clark et.al., 1998, p.118). The study of attitude has a long and complex history in psychology. Most researchers appear to agree that an attitude is a state of readiness, a tendency to respond in a certain manner when confronted with certain stimuli, (Oppenheim, 1992, p.174).

Belief questions can be distinguished from those that aim to establish the individual's attitudes. Whereas belief questions ascertain what the individual thinks is true, attitude questions (open-ended questions) attempt to establish what he thinks is desirable (de Vaus, 1996, p.82). In a questionnaire, attitudes have to be inferred from expression of opinions or belief. There are many ways of getting evidence about a person's attitude, other than verbal expression, such as body language or other forms of non-verbal behaviour. Moreover, Clark et al (1998, p 117)) argued that:

> Attitudes reveal themselves because they have a quality of being positive or negative. This quality can be observed. It is also a quality that attitudes share with another aspect of human behaviour -the opinion. Consequently one leads to judgement of the other and more often than not the two concepts become coterminous.

Indeed, an individual's opinions on matters often provide evidence of his attitudes, but this does not mean that an opinion is the same as an attitude. There should be some consistency between respondents' verbal expressions of their attitudes towards a particular phenomenon and their

[27] See Oxford Advanced Learner's Dictionary, fifth edition, 1995.

behaviour towards it, (Ibid., p.117). A major distinction between attitudes and opinions is presented in Table 6.1 below.

Table 6.1: A major distinction between attitudes and opinions

Characteristic	Attitudes	Opinions
Focus and fixity	They tend to be focused on an object, a person, group, specific behaviuor and particular ideas. They also tend to be fairly fixed over time. They are fairly stable in the short and medium run.	They are relatively changeable.
Feeling	They are closely related to feelings	Opinions may or may not carry connotations of feelings.

Attitudes are reinforced by beliefs (the cognitive component) and often attract strong feelings (the emotional component), which lead to particular behavioural intents (the action tendency component), [Oppenheim, 1992, p. 175]. However, in accounting research, persons' expressions of opinions are typically treated as indicators of attitudes. This study is mainly concerned with the analysis of verbal expression, which are opinions as proxies for attitudes towards the implementation of new accounting standards. More specifically, the present research study aims to elicit the respondent's opinions about the implementation of the accounting standards, from the perspective of Islamic banks. The opinions of the respondents provide an indication of their attitudes. Thus the degree of 'agreement' or 'disagreement' as expressed in their opinion indicates positive or negative attitudes towards the implementation of the standards.

How can a researcher measure something that is in a person's mind? The simple answer is to ask people. Researchers depend on this approach and often use questionnaires, where respondents are asked to indicate whether they agree or disagree with a set of statements (items) in connection with the implementation of the accounting standards. In other words, researchers look at the direction of opinion (positive or negative) about some set of statements.

6.3 Types of scale

Another important aspect to consider prior to deciding on methods of analysis is that variables may be measured by using different levels of scales. According to de Vaus (1996) there are three main levels of measurement scales. These are:

a) Nominal scale, in which a distinction between categories of a variable can be made, but one cannot rank the categories in any order (e.g., the color of eyes)
b) Ordinal scale, in which it is meaningful to rank the answers by categories, but it is not possible to quantify precisely how much difference there is between categories.
c) Interval/ratio scale, in which ranking of categories can be made and it is possible to quantify the differences between the categories precisely.

Depending on the scale, different types of statistical tests and measures are applicable to a particular set of data. Clark et al. (1998, pp. 153-154) presented the following common types of the scale data:

i) Nominal and ordinal scale data

Nominal data assumes no natural ordering, i.e. there is no particular ordering that suggests itself. In contrast, ordinal data assumes ordering. An example of ordinal data is 'Rating Scales'. They can be used to describe a respondent's opinions on a particular phenomenon. It can be noted that nominal and ordinal data are essentially categorical in nature. Saunders et al (2000, p.328) defined categorical data as "data whose values cannot be measured numerically". Yet, categorical data can be either classified into sets (categories) according to the characteristics in which one is interested or placed in rank order. They can be further subdivided into descriptive and ranked data. Nominal data equate to descriptive data, for which it is impossible to measure values numerically or to rank them. Descriptive statistics (mode, frequency counts) are appropriate for nominal scaled data because they focus on frequencies in categories (Siegal and Castellan, 1988, p. 25).

Ordinal data equate to ranked data. Ordinal data are more precise, in which one knows the definite position of each element within the data set. The statistic most appropriate for describing the central tendency of scores in an ordinal scale is the median. With ordinal scaled data , propositions can be tested by using nonparametric statistical tests which are sometimes called ranking statistics. Sekaran (2000, p. 180) stated that the ordinal scale provides no indication of the magnitude of the difference among the ranks.

ii) Interval and ratio scale data:

Interval scaled data assumes that values progress both in order and according to a series of equal steps. In other words the distances (intervals) between numbers can be measured precisely. An interval scale is characterized by a common and constant unit of measurement, which assigns all numbers to all pairs of objects in the order set. In this sort of measurement, the ratio of any two intervals is not independent of the unit of measurement and of the zero point. In an interval scale, the zero point and the unit of measurement are arbitrary. Hence, interval scales need not include a zero point. By contrast, there is an absolute zero point on the ratio scale. In a ratio scale, the ratio of any two-scale points is independent of the unit of measurement. Interval scale data may be continuous or discrete and the same is true for cases that display ratio scale properties. Continuous data theoretically take any value on the continuum of real numbers (0,1-100), provided that one can measure them accurately. Discrete data, by contrast, may have only a finite countable number of values (0,1-100) that can be measured precisely. In other words each case takes one of a finite number of values from a scale, which measures changes in discrete units (Saunders et al, 2000, p..328). Data measured in interval or ratio scales may be analyzed by parametric statistical tests if all of the assumptions of the parametrical statistical model are appropriately satisfied. Although rating scales (such as the Likert scale as discussed in Section 6.4 below) are ordinal in nature, they are often viewed as having interval scale properties. This may be attributed to the fact that researchers calculate average scores for rating scale data, which indicate that they are being treated as interval scale i.e. cardinal data. As part of the present research study, MGRs and EAs of Islamic banks were asked to rank their opinions about a set of statements regarding the implementation of the accounting standards.

6.4 Measurement techniques

A scale must satisfy the conditions of linearity and uni-dimentionality; it must be reliable (consistent); it must have units of measurement. The scale must be valid, (Oppenheim, 1992, p.155). Most research textbooks mention the main four types of measurement techniques in connection with questionnaires (e.g. de Vaus, 1996, Punch, 1998 and Clark et al. 1998). These are:

1) Thurstone technique:
   The basis of this scale is that respondents are asked to express to what extent they favour a defined item. The poles of the scale are "strongly approve" and "strongly disapprove" separated by a seven-point scale in which point 4 is neutral. The scale is based on the assumption that the intervals between the numbers are equal.
2) The Cuttman scale:
   The Cuttman scale assumes that an attitude can be measured along a single continuum represented by a set of statements, which are ordered in terms of degrees of acceptability. That is to say the scale moves in one direction towards greater acceptability and in the opposite direction towards greater unacceptability. In Cuttman's technique (semantic differential format), the format consists of choosing objectives to represent the two extremes on a continuum and asking the respondent to put a mark between the two extremes.
3) Checklists:
   These consist of a list of items and the respondent is asked to circle each relevant item.
4) Likert's technique:
   This technique is called attitude or opinion rating. It involves providing people with statements and asking them to indicate how strongly they agree or disagree (Alreck and Settle,1995).

The Likert scale provides answers in the form of coded data that is comparable and can readily be manipulated. Moreover, the scale is flexible in the sense that items (statements) can be only a few words, or they can consist of several lines. The scale is economical because one set of instructions can be used and the scale can serve many statements, and once the respondent understands what is required he or she can complete the items very quickly and easily, particularly when the issues have been articulated in advance as statements. Although the Likert scale has many advantages, it also has some disadvantages. According to Oppenheim (1992, p.200), one of the main such disadvantages is that a question arises as to whether one can assume equal intervals within the same scale, i.e. whether the distance between scale points 2 and 3 is the same as that between 4 and 5. Secondly, there is an uncertainty over the inter-subject judgement of the scale. In other words, does "strongly agree" from respondent X mean exactly the same as an "strongly agree" from respondent Y for the same items. Thirdly, there is a problem with the position of the middle point called often "neutral", the question at stake is to what extent the middle point can be seen as the real midpoint between the two extremes of agreement and disagreement: is it really a neutral point? Despite the reservations expressed by Oppenheim, Likert scales are commonly treated as interval scales. Likert scale, whereby a respondent responds to each item according to a simple response scale, rather than a dichotomy, and responses to the items can then be summed. This implies that the scale is seemed to be an interval scale. According to Sekaran (2000, p. 198) the interval scale is used and the differences in the responses between any two points on the scale remain the same

In consideration of both advantages and disadvantages of the Likert scale, however, the simpler procedures of Likert came over time to be used as more relevant for attitudes and opinions' measurement. Alreck and Settle (1995) contended that the Likert's summated rating procedure is widely used in social science today. They added that it is the form of scaling most often seen in questionnaires used in research.

The Likert scale utilizes, typically the range of "strongly agree", "agree". "neutral", "disagree" and "strongly disagree" (Alreck and Settle, 1995), though as few as 3-scale points are often used, and as many as 7-points. If one had too few response categories, each would be very diverse, grouping people with quite different opinions or different levels of commitment into the same category. On the other hand, if too many categories were used, the respondent would not be able to distinguish between adjacent categories and might get frustrated and refuse to answer (Bailey, 1978, p. 115). For this study respondents were asked to give their views, on the implementation of set of statements issued by AAOIFI's, according to scale of 1-5 where:
strongly disagree =1, disagree = 2, neutral = 3, agree = 4 and strongly agree = 5. The use of 5-point scale was preferable to allow respondents to indicate a degree of agreement or disagreement[28].

[28] The number of respondents was too small to allow statistical tests of significance to be applied to the data from the 5-point scales. Hence for statistical tests (tests of significance), the 5-point scales was collapsed into a 3-point scales.

Reliability of scale measurement

The purpose of conducting reliability tests is to determine consistency of the scale measurement. A reliable measurement is one where the same results on the same occasions (de Vaus, 1996, p.54). There are two aspects of reliability:

1. External reliability, which refers to the degree of consistency of a scale measurement over time. This can be assessed by a number of well-established methods of testing, including the test- retest method. Due to time and budget constrains; the researcher could not apply this.
2. Internal reliability, which is an indicator of how well several different items measure the same variable. The internal reliability can be assessed through a number of methods in SPSS software. The most common methods are:

a. Split-half reliability, which splits the items in scale into two groups and examines the relationships between respondents' scores for the two halves.

b. Cronbach's alpha, which calculates the average of all possible split-half reliability coefficients. Cronbach's alpha ranges in value from 0 to 1 because it can be interpreted as a correlation coefficient. The higher the value of alpha the more reliable the scale. As a rule of thumb alpha should be at least 0.7 [29].

For the present study, the Cronbach's alpha and split half reliability were used to measure the internal consistency of the scale. The results of the two tests are presented below.

Table 6.5 indicates that for Questions 2 and 3 in Section A, Questions 2 in Sections B1-B5 and Question2 in Section C both alpha and split-half methods produce high coefficients (See Appendix 13a-13c). This means that each scale in the study questionnaire measures a single concept and the items that make up the scale are internally consistent. That is to say, the scale measurement of this questionnaire is internally reliable. It was not applicable to calculate the Cronbach's alpha and Cuttman split-half methods for question 1 in Section A, questions 1 in Sections B1-B5 and question 1 in Section C, for the reason that no linear, numeric scale was used.

[29] See De Vaus, 1996, 255- 57.

Table 6.2: Reliability analysis of the questions

Question #	Alpha	Split-Half
[Q2 (Section A)	0.9798	0.8835
[Q2 (Section A)	0.9400	0.7733
[Q2 (Sections B1-B5)	0.9454	0.8501
[Q2 (Section C)	0.7106	0.8024

6.5 The research instrument

The data can be obtained by questionnaires, in-depth interviews and or by a range of other techniques.

6.5.1 Questionnaire

The most widely used technique is the questionnaire. Questionnaires can be filled out by respondents and returned to the researcher or administered by interviewers. The questionnaire is a highly structured data acquisition method, whereby each respondent is asked the same set of questions (de Vaus, 1996, p.80).

The advantages of using questionnaires include (Oppenheim, 1992, p. 102):

1- Low cost of data collection.
2- Low cost of data processing.
3- Ability to reach respondents who live at widely dispersed addresses or abroad.

However, the use of questionnaires has limitations. The main limitation of the questionnaire is the possibility of a low response rate and consequent biases. This can be minimized by careful thinking and pilot tests (de Vaus, 1996).

Type of the question

According to de Vaus (1996), the choice between open-ended (attitude questions) or closed-ended (opinion questions) depends on many factors such as the question content, the respondents' motivation, method of administration, type of respondent, and the amount of time available to develop a good set of unbiased responses. Likert scale questions are necessarily closed-ended questions, i.e., asking for respondents' opinions on a set of statements.

The main advantages of closed-ended questions are:

(1) The answers are standard, and can be compared from one respondent to another.

(2) The respondent is often clearer about the meaning of the question; i.e. a respondent who is unsure about the meaning of the question can often tell from the answer categories what is expected.

(3) The answers are much easier to code and analyze and often can be coded directly from the questionnaire.

(4) The answers are relatively complete and the minimum of irrelevant responses is received.

(5) The questions are often easier for a respondent to answer, as he or she merely has to choose a category.

However, the main disadvantages of the closed-ended question are:

(1) it is very easy for a respondent who does not know the answer or has no opinion to "guess" an answer;

(2) The respondent may feel frustrated because the appropriate category for his or her answer is not provided at all or not provided in sufficient detail.

(3) There may be too many answer categories so that the respondent could not remember them. This causes rereading and repetition, and can lead to errors.

(4) Differences in interpretation of what was meant by the question may go undetected.

(5) There is some likelihood of a clerical error as the respondent may, for example, circle "three" when he or she meant to circle "two".

Despite these disadvantages, closed-ended questions are generally self-contained, can be answered quickly and require fewer instructions than open-ended questions. Thus, closed-ended questions can be used with respondents that have a lower educational level and are considered to be more appropriate for mail-out and self-administered questionnaires. (Bailey, 1978, p.104).

6.5.2 Interview

Though questionnaires may be used as the only data collection method, it is usually useful to link them with other methods in a multiple-method approach. For example, a questionnaire to discover respondents' opinions can be complemented by in-depth interviews to explore and understand their attitudes. The interview is the most useful method of collecting qualitative data, when it gives insight into how individuals or groups think about their world, and how they construct the reality of the world (Clark, (1998, p.132). The interview often provides extra comments and observations to be made by the interviewee, who helps the researcher to assess respondents' attitudes towards, and opinions on, the implementation of the accounting standards

6.5.3 Documentary sources

Documentary information is relevant to case study topic. The type of information takes many forms, e.g., letters, agenda, reports. The most important of documents is to corroborate and augment evidences from other sources. (Yin, 1994, p. 81). This can be carried out in order to obtain a better understanding of the banks' actual implementation of the accounting standards.

6.6 The selection of banks and audit firms

MGRs of Islamic banks and their EAs are used as sub-units of analysis. This is because the information required is about opinions of preparers (MGRs) and EAs on the implementation of the accounting standards as indicators of their attitudes. The number of banks and audit firms in Sudan was limited, thus making the question of sampling approach problematic. Despite the fact that there are no general criteria for selecting units of analysis within the case study, the researcher attempted to select a number of banks in the following way.

During the same visit in April-July 1998, the researcher made several personal visits to the CBS and examined documentation related to banks in Sudan. Based on this examination, there were 28 banks in the banking sector in Sudan (excluding the Bank of Sudan)[30]. According to the CBS, banks were classified into the following three categories[31]:

1- Twelve public (state-owned) banks

2- Twelve privately-owned banks

3- Four foreign branches

Since the number of banks was small, the selection of seven banks was considered to be sufficient for this study. The seven banks were selected as follows [32]:

1. Three out of twelve state-owned banks: *Alpha* and *Zubra* are publicly owned banks with a larger number of branches, they had no bonus plans and they were not listed on the local stock market. *Frasa* is a semi publicly-owned bank with a smaller number of branches and it was listed on the local stock market. *Alpha*, *Frasa* and *Zubra* banks are therefore suitable for treatment as public banks.

2. Three out of the twelve privately- owned banks: *Beta*, *Hadatha* and *Sayada* banks had bonus plans and were listed on the local stock market. *Beta*, *Hadatha* and *Sayada* banks are therefore suitable for treatment as private banks

3 One out of four branches of foreign banks: *Asdar* bank had a bonus plan and it was not listed on the local stock market. *Asdar* bank is therefore suitable for treatment as a foreign operation.

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[30] In the year 2000 the number of banks decreased from 28 to 25 due to the liquidation of two private banks and one foreign branch.

[31] For statistical purposes both 100% publicly owned banks and semi-publicly owned banks (in which the state owns more than 50% of the bank's shares) were treated as publicly owned banks, where privately owned banks and foreign branches were treated as privately owned banks.

[32] The names of the banks have been disguised for the realm of confidentiality.

Table 6.3 presents the main characteristics of the selected banks.

Table 6.3: Banks' characteristics for the financial year 1997 (Amount in US $(000)[33])

Banks (1)	Bank class (2)	Total assets US $ 000 (3)	Receivables US $ 000 (4)	% of receivable to total assets (5) (4:3)	Revenue US $ 000 (6)	Profit after payment to depositors (7)	% (8) (7:6)	Number of branches (9)	Listing status 10)
Alpha	PNB	108001 L	21262	20 H	6924	123	2 W	41 L	Non listed
Beta	RB	69105 S	7029	10 W	3659	154	4 W	20 S	Listed
Zubra	PNB	148246 L	35504	24 H	16955	1189	7 W	112 L	Non listed
Frasa	PNB	25184 S	166	6 W	3776	196	5 W	21 S	Listed
Hadatha	RB	108076 L	10368	10 W	11104	2468	22 L	18 S	Listed
Sayada	RB	33580 S	5115	15 H	4075	420	10 W	45 L	Listed
Asdar	RB	8398 S	442	5 W	867	240	27 L	1 S	Non listed
Total		500590						258	

PNB: public bank with no bonus, RB: private bank with bonus, L: larger, S: smaller, H: higher, W: lower.

The subjects of the study (respondents) included the General Manager or his Deputy (GM), the Financial Manager (FM), the Investment Managers (IM) and the EAs of each selected bank in Sudan. However, the number of EAs was 5 instead of 7, owing to the fact that the three public banks were audited by the Auditor General.

The reasons for the choice of each group of the respondents were:

GMs: they have overall responsibility for the preparation of financial statements of Islamic banks, and they have a responsibility to ensure that the financial statements are prepared in accordance with AAOIFI accounting standards.

FMs: they have financial functional responsibility for the implementation of the disclosure and measurement standards including Equity of Investment Account Holders.

IMs: they have particular responsibility for the implementation of the measurement standards for *Murabaha, Mudaraba, Musharaka* and *Salam*.

EAs: they express their opinions as to whether the financial statements are prepared in accordance with AAOIFI's accounting standards.

[33] Source: The Economic Review 1998, Ministry of Finance and National Economy; "Government and Public entities". Figures were converted from SDD to US $ at official rate (1 US$= 1684).

6.7 The conduct of pilot case study

Each question and the questionnaire as a whole must be evaluated rigorously before final administration of the questionnaire (de Vaus, 1996). The research questions and questionnaires were first pretested during May-July 1998 on two sites (Islamic banks) and one audit firm. This served the following purposes:

1. To ascertain the nature of any available records, documents, and other sources of evidence that might be drawn upon, in addition to information created by new data collection exercises such as questionnaire, interviews and observation.
2. To check whether respondents understand the language used in the questionnaire.
3. To check whether questions used generated answers relevant to the purpose of the study.
4. To discover whether there are a major topic omissions.
5. To provide an idea of the validity of the questions those are being asked.
6. To provide an idea of the reliability of the questions by checking responses from individual respondents to similar questions.
7. To provide limited test data so that one can check that the proposed analysis will work.

To work out which statements legitimately belong to the scale, the steps below were followed:

1- Questions were designed using a Likert-type scale in which a respondent is asked how strongly he agrees or disagrees with each statement. The statements (items) were selected to reflect the direction of the respondents' opinions on the implementation of AAOIFI accounting standards.

2- The questions then were answered by individuals (e.g. GMs, IMs, FMs and EAs.).

3- For positive statements, strongly agree would get a high score, while strongly disagree would get a low score.

Finally, respondents were asked about the following general questions:

1- Were the instructions clear?

2- Were any of the statements (items) unclear or ambiguous?

3- Did they object to answering any of the questions?

4- Was the lay out of the questionnaire clear and attractive?

5- If they have any comments and suggestions.

The respondents were contacted over the telephone asking them to arrange for a meeting in their banks. During the meeting, the questions were discussed face to face with GM or Deputy (DGM), IM, FM in each bank, and an EA from reputable audit firm, and their responses were recorded simultaneously. The discussion was held in Arabic and accordingly the questions were discussed in Arabic too. Although the original version of the questions was in English, the interviewees preferred to have discussion in Arabic in order to minimize misinterpretation of the questions.

Table 6.4: The distribution of the questionnaires in the pilot testing

Group	Number
GM	2
IM	2
FM	2
EA	1
Total	7

The main findings of the pilot testing were as follows:

1- Based on the findings from the initial interviews; GM and DGM were found to be more concerned with the requirements of the disclosure standard than those of the measurement standards. On the other hand, IM and FM were found to be more concerned with the requirements of the measurement standards than those of the disclosure standard. This suggested to the researcher to separate the disclosure standard (FAS 1) from the measurement standards. Accordingly, the GMs or DGMs were asked about statements (items) relating to the requirements of the disclosure standard and the evaluation of the associated costs of compliance, whereas the FMs and IMs were asked about items pertaining to the requirements of the measurement standards.

2- All of the respondents confirmed that the instructions were clear.

3- All of the respondents confirmed that the statements were clear and not ambiguous.

4 None of the respondents objected to answering any question

5 Respondents confirmed that the layout of the questionnaires was clear.

6 Suggestions were given to omit items relating to the financial statement of the *Zakat* fund since the responsibility of collection and the distribution of *Zakat* funds rest with the State (Chamber of *Zakat*). As a result, items related to the statement of *Zakat* funds were omitted.

The analysis of the findings from the pilot study:

Cross-sectional comparisons indicated that there was no difference in banks MGRs' attitudes towards, and opinions on, disclosing information, in accordance with AAOIFIs' FAS 1, to the board of directors and the CBS[34]. However, the findings indicate that there was a significant difference in bank MGRs' attitudes towards, and opinions on, disclosing information, in accordance with AAOIFIs' FAS 1, to shareholders, investment account holders, current account holders, Khartoum stock exchange and the general public. For measurement standards, the cross-sectional comparisons indicate that there was a significant difference in bank MGRs' attitudes towards, and opinions on, the implementation of the measurement standards[35] (See Appendix 11).

With regard to the evaluation of audit risk by the EA, the Deputy Auditor General was asked to evaluate the implications of new accounting standards for audit risk associated with implementation of the accounting standards. An EA from a private audit firm was requested to test the questionnaire. Accordingly, the questionnaire was redesigned to include questions about the audit risk associated with *Shari'a* non-compliance (See Chapter 5, Section 5.3 above).

6.8 Methods of data acquisition

Having discussed the pre-testing of the questions and questionnaires, the discussion moves to cast light on the administration of the questionnaires, face to face interviews and examination of document.

6.8.1 Questionnaire Administration

For the aim of this research study, structured questionnaires were designed in order to elicit the opinions of MGRs and EAs of banks on the implementation of the accounting standards in Islamic banks in Sudan. The administration of the questionnaires was conducted from October 1998 to December 1998, during a personal visit by the researcher to Sudan. Prior to the personal visits to the banks in Sudan, three key persons working in each selected bank were contacted over the telephone

[34] Because Islamic banks in Sudan are required to disclose all necessary information to the bank's board of directors and the CBS, which is the body that regulates banks. Therefore, the statements (items) relating to those users were omitted from the original questionnaire.

[35] Measurement standards include *Murabaha* and *Murabaha to Purchase order*er, *Mudaraba* Financing, *Musharaka* Financing, *Salam and Parallel Salam* and Equity of Investment Accounts.

asking them to arrange for a meeting. During the meeting the questionnaire was introduced, details of the questionnaire were discussed and definitions and terminology were explained. And then the questionnaires were handed out with covering letter to each respondent. Depending on the topic of the questionnaire, the GMs or DGMs were asked to answer questions regarding the implementation of the disclosure standard. Moreover, IMs were asked to answer questions concerning the implementation of the measurement standards, namely *Murabaha*, *Mudaraba*, *Musharaka* and *Salam*, and the FMs were asked to answer questions pertaining to the measurement standard on Equity of Investment Account Holders. Furthermore, EAs were asked to answer questions concerning their evaluation of the implication of audit risk associated with the implementation of AAOIFI's accounting standards. The questionnaires were administered in the Arabic language, which is the mother tongue and working language of the respondents. English language versions of the questionnaires are included as appendices to this study.

Data acquisition is organized as follows:

a. A questionnaire was used for the disclosure standard. The covering letter accompanying the questionnaire clarified and explained the objectives of the research study. The questionnaire then was divided into three sections. Section (A) dealt with the implementation of the disclosure standard. In (A2) respondents were asked to categorize a set of statements (items) in connection with the implementation of the disclosure standard. In (A3) respondents were also asked to evaluate the cost of compliance associated with the implementation of the disclosure standard (See Table 6.5 below). Replies from the respondents were obtained by asking each one to answer questions using a 5-point Likert scale (ranking from strongly disagree = 1 to strongly agree = 5) (See Appendix 4 below).

Table 6.5: The main contents of the questionnaire relating to disclosure requirements

Section	Information type	No of items
A1	Familiarity with the standard	1
A2	Disclosure requirements	21
A3	Cost of compliance	3

b. For the five measurement standards, five questionnaires were designed to measure the opinions of FMS and IMS on the implementation of (i) *Murabaha and Murabaha to the Purchase Orderer*, (ii) *Mudaraba* Financing, (iii) *Musharaka* Financing, (iv) *Salam and Parallel Salam* and (v) Equity of Investment Account Holders. Each questionnaire was divided into three main sub sections. Subsection (1) introduced the study to the respondents including question about the measurement standard. In subsection (2) respondents were asked to categorise a set of statements with regard to the implementation of the measurement standard. In subsection (3) respondents were asked to assess the need for training relating to the implementation of the measurement standards. Replies from the respondents were obtained by asking each one to answer questions using a 5-point Likert scale[36] (ranking from strongly disagree = 1 to strongly agree = 5) (See Appendixes 5 through 9 below).

c. With regard to the assessment of implications for audit risk associated with the implementation of the accounting standards, a questionnaire was designed to elicit EAs' opinions on the implementation of the accounting standards and the associated audit risk. The questionnaire was divided into two sections. Section (C1) introduced the scenario about the disclosure standard. In section (C2) respondents were asked to evaluate the implications for audit risk associated with the implementation of the disclosure standard. Section (C3) dealt with the scenario concerning the implementation of the measurement standards (e.g., *Murabaha* and *Salam* standards). In section (C4) respondents were asked to evaluate the implications for audit risk associated with the implementation of *Murabaha* and *Salam* standards. Replies from the respondents were obtained by asking each one to answer questions using a 5-point Likert scale (ranking from very low = 1 to very high = 5) (See Appendix 10 below).

[36] Because of the limited amount of data, for the purpose of certain statistical tests the 5-point scales was collapsed into 3-point scales.

In total 47 questionnaires were distributed as follows:

Group	Number
GMs	7
FMs	7
IMs	28
EAs	5
Total	47

6.8.2 Face to face interview

After the receipt of completed questionnaires from each selected bank, the researcher met the GM or DGM, the IM and the FM. During the meeting the questions were discussed face to face with interviewees. Follow-up questions were asked to lead the respondent to answer more fully and accurately. An audio recorder was used in the interview (the interview guide is presented in Appendix 12). The discussion was held in Arabic and accordingly the questions were addressed in Arabic too, although the original version of the interview guide is in English.

6.8.3 Examining banks' annual reports

As already stated in chapter 5 above, one of the main objectives of this thesis is to compare and contrast the implementation of the disclosure standard (FAS 1) in a number of Islamic banks in Sudan. Therefore, banks' annual reports are uniquely suitable to examine banks' implementation of the disclosure standard. Reviewing the bank's annual report was also used to establish the similarities and a difference between banks in terms of their respective accounting polices. Moreover, banks' annual reports were used to obtain information about certain banks' characteristics (independent variables including number of branches, assets size, listing status, bank ownership and proportion of receivables to total assets)

6.9 Methods of data analysis

Having chosen the appropriate method of analysis, the choice of statistics is affected by both the method of analysis itself, the level of measurement of variables and the complexity of research questions (de Vaus, 1996). Kinnear and Gray (2000) suggested that the selection of statistical methods depends upon:

- the research question
- the plan, or design, of the research, and
- the type of data

Siegel and Castellan (1988, pp. 33-34) have argued that the proper interpretation of parametric tests is not only based on the normal distribution, but also assumes that the scores being analyzed result from measurement in at least an interval scale. However, as indicated earlier, most questions in this study's questionnaires used a five-point Likert scale in order to measure the respondents' opinions about sets of statements concerning the implementation of the accounting standards. Responses to the statements can be summed. This implies that the Likert scales are commonly treated as interval scales and one might still use non-parametric statistics, because of non-normality. The statistical methods used are described below:

1 Descriptive statistics:

Descriptive statistics are summaries of data, which can be tabular, numerical or graphical. Green et al (2000, p. 120) state that descriptive statistics involve summarization of distributions of scores by using tabular or graphical presentation and computation of descriptive statistical measures. With regard to questions 2 & 3 (Section [A]), 2 (Sections [B1- B5]) and 2 (Section [C]), there was a linear numeric scale and thus it was feasible to calculate different types of descriptive statistics such as mean, the mode, the percentage, etc. Due to the limited number of respondents, the researcher made use only of the tabular and graphical presentation. With respect to questions 1 (Section [A]), 1 (Sections [B1-B5]) and 1 (Section [C]), there was no linear numeric scale

2. Statistical analysis: Non-parametric tests of significance

In order to analyze data acquired from the respondents, the following non-parametric tests were used. They are based on the nature of data, the number of groups involved in the comparison, and the number of dependent and independent variables.

i- The chi-square test of significance

The chi-square test was used to measure the association between dependent variables and independent variables. Chi-square calculations are based on frequency distributions. The test is appropriate for testing the goodness-of-fit for variables. This is because the test can be applied to determine whether or not an observed set of frequencies matches some expected set of frequencies. Chi-square contingency tables tests are particularly valuable tests, because they are relatively simple to understand and apply. Moreover, the data can be of any level, [i.e., nominal, ordinal interval or ratio (Clark, et. al., 1998)]. For example, values from a 5-point linear, numeric scale are equal interval data, but the range of values is limited. There are no fractions or decimals in such data, and the integer values can be used to define five categories for analysis of relationship with another categorical variable using contingency table analysis. To ensure the validity of a chi-square test of significance, expected cell frequencies are supposed to be five or greater than five. However, the selected banks in Sudan were small in number. In order to ensure the expected cell frequencies of at least 5, the number of categories had to be minimized as well as the number of groups. More specifically, strongly disagree and disagree were amalgamated as negative response and strongly agree and agree were amalgamated as positive response. In this study, a Chi-square contingency table test was used to test the theoretical propositions (P1 through P5).

ii- Kruskal -Wallis (K-W) test of significance

This test is a non-parametric alternative to the one way between group ANOVA (Analysis of Variance) and allows one to measure the difference between two groups or more. In the present study, the Kruskal-Wallis test was used to test the theoretical propositions (P6 and P7 in Chapter 5 above) concerning EAs' evaluation of implications for audit risk associated with the implementation of AAOIFI's accounting standards.

6.10 Summary and concluding remarks

A respondent's opinions on matters often provide evidence of his attitudes, but that does not mean opinion is the same as attitude. However, in accounting research, persons' expressions of opinions are typically treated as indicators of attitudes. This study is mainly concerned with the analysis of banks' actual compliance as well as their MGRs' opinions about the implementation of the accounting standards.

Bank MGRs and EAs' opinions on the implementation of the accounting standard can be addressed by a survey within a case study approach. This study used a survey questionnaire as a data acquisition method. The questionnaires were administered in the Arabic language, which is both the mother and working language of the respondents. English language versions of the questionnaires are included as appendices to this study. Five-point Likert scales were used to obtain the respondents' opinions on the accounting standards. However, for some statistical purposes (tests of significance) the 5-point scales were collapsed into the 3-point scales.

As part of the present research study, MGRs and EAs of Islamic banks were asked to rank their opinions about a set of statements (these statements concerned the implementation of the accounting standards). In other words the respondents were asked how much they agreed or disagreed with such statements. The chapter then has focused on data acquisition and analysis. Questionnaire, interviews and examination of documents were used as data collection methods. A contingency table analysis was used to test the theoretical propositions concerning MGRs' opinions on the implementation of the accounting standards. The non-parametric Kruskal Wallis test was also used to test the theoretical propositions related to EAs' opinions on the implementation of the accounting standards. The findings from the case study will be analysed and discussed in the following chapters. Hopefully, the findings will enrich the literature with an empirical evidence of MGRs' and EAs' opinions about the implementation of the accounting standards.

Part IV Data Analysis, Discussion and Conclusion

Chapter 7

Bank MGRs' Opinions on the Implementation of the AAOIFI's (FAS 1)

7.1 Introduction and objective

In chapter 5 (section 5.2.1 and 5.5) above, the following research questions were developed to test the cost of compliance proposition (P1) and the listing status proposition;

1- To what extent do MGRs of Islamic banks display positive or negative attitudes towards, and opinions on, the implementation of AAOIFI's accounting standards?

2- How do Islamic banks differ in their actual implementation of AAOIFI's accounting standards?

The two questions are supplemented by some other more specific questions. They are:

i. How much do the MGRs of the banks studied agree or disagree in their attitudes towards, and opinions on, the implementation of AAOIFI's disclosure standard?
Within this question further itemized questions were asked in order to elicit the opinions of respondents about the requirements (21 items within each five sub - items) of the disclosure standard. (.....See Appendix 4 below).

ii. How do banks differ in their actual compliance with the requirements of AAOIFI's disclosure standard?

A case study approach, with cross-sectional comparisons, is used in the present chapter to test whether the theoretical propositions, derived from the existing research literature, fit the data. These theoretical propositions are related to opinions of banks' MGRs about the implementation of the new AAOIFI's disclosure standard (hereafter referred to as the standard). They include the cost of compliance proposition (P1) and the listing status proposition (P2). The main purpose of this chapter is therefore, to analyze and discuss the findings of the single (embedded) case study (namely that of Sudan) relating to banks MGRs' opinions as well as their actual compliance with the standard.

The remainder of this chapter is organized as follows:
Section 2 presents the findings of the empirical work relating to MGRs' attitudes towards, and opinions on the requirements of the standard. Section 3 provides a descriptive analysis of similarities and differences in bank MGRs' attitudes towards, and opinions about, the implementation of the standard. Statistical tests of the cost of compliance proposition (P1) and the listing status proposition (P2) are presented in Section 4. Section 5 compares and contrasts banks' actual compliance with the requirements of the standard. Section 6 discusses the main findings of the case study. Section 7 provides summary and concluding remarks.

7.2 The findings of the empirical work regarding bank MGRs' opinions on the implementation of the standard.

Question 2 in section A concerns the attitudes and opinions of banks' MGRs on the requirements of the standard.

Question 2 in Section A: How much do you agree or disagree with the following disclosure requirements [items 1-21]

1- The bank's statement of financial position, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users:
1.1 Shareholders.
1.2 Investment Account Holders.
1.3 Current Account Holders.
1.4 Khartoum Stock Exchange.
1.5 General Public.

2 Bank's statement of income, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users:
2.1 Shareholders.
2.2 Investment Account Holders.
2.3 Current Account Holders.
2.4 Khartoum Stock Exchange.
2.5 General Public.

.3- Bank's cash flow statement, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users:
3.1 Shareholders.
3.2 Investment Account Holders.
3.3 Current Account Holders.
3.4 Khartoum Stock Exchange.
3.5 General Public..
4- Bank's statement of changes in owners' equity or a statement of retained earnings, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users:
4.1 Shareholders.
4.2 Investment Account Holders.
4.3 Current Account Holders.
4.4 Khartoum Stock Exchange.
4.5 General Public.
5- Bank's statement of changes in restricted investment, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users:
5.1 Shareholders.
5.2 Investment Account Holders.
5.3 Current Account Holders.
5.4 Khartoum Stock Exchange.
5.5 General Public.

6- Bank's statement of sources and uses of fund in the Quard fund, in accordance with AAOIFIs' FAS 1 should be disclosed to the following users:

6.1 Shareholders.

6.2 Investment Account Holders.

6.3 Current Account Holders.

6.4 Khartoum Stock Exchange.

6.5 General Public.

7- Significant accounting policies, in the bank's notes to its financial statements, should be disclosed to the following users:

7.1 Shareholders.

7.2 Investment Account Holders.

7.3 Current Account Holders.

7.4 Khartoum Stock Exchange.

7.5 General Public.

8- An unusual supervisory restrictions imposed on the bank's activities by the Central Bank of Sudan, should be disclosed to the following users:

8.1 Shareholders.

8.2 Investment Account Holders.

8.3 Current Account Holders.

8.4 Khartoum Stock Exchange.

8.5 General Public.

9- Earnings (e.g. earnings from *Haram* transactions) and expenditures prohibited by Shari'a, if any, should be disclosed to the following users:

9.1 Shareholders.

9.2 Investment Account Holders.

9.3 Current Account Holders.

9.4 Khartoum Stock Exchange.

9.5 General Public.

10- Bank's concentration of assets risk should be disclosed to the following users:

10.1 Shareholders.

10.2 Investment Account Holders.

10.3 Current Account Holders.

10.4 Khartoum Stock Exchange.

10.5 General Public.

11- Concentration of sources of unrestricted investment accounts, should be disclosed to the following users:
11.1 Shareholders.
11.2 Investment Account Holders.
11.3 Current Account Holders.
11.4 Khartoum Stock Exchange.
11.5 General Public.

12- Distribution of unrestricted investment account, in accordance with their respective periods to maturity, should be should be disclosed to the following users:
12.1 Shareholders.
12.2 Investment Account Holders.
12.3 Current Account Holders.
12.4 Khartoum Stock Exchange.
12.5 General Public.

13- Any material amounts the bank is obliged to deposit with others as compensating balances, should be disclosed to the following users:
13.1 Shareholders.
13.2 Investment Account Holders.
13.3 Current Account Holders.
13.4 Khartoum Stock Exchange.
13.5 General Public.

14- Bank's risk associated with assets and liabilities which are denominated in foreign currencies, should be disclosed to the following users:
14.1 Shareholders.
14.2 Investment Account Holders.
14.3 Current Account Holders.
14.4 Khartoum Stock Exchange.
14.5 General Public.

15 Risk associated with the bank's contingencies (e.g. letter of credits and letter of guarantee) should be disclosed to the following users:
15.1 Shareholders.
15.2 Investment Account Holders.
15.3 Current Account Holders.
15.4 Khartoum Stock Exchange.
15.5 General Public.

16- The nature and the amounts of the bank's outstanding financial commitments, as of the statement of financial position date, should be disclosed to the following users:
16.1 Shareholders.
16.2 Investment Account Holders.
16.3 Current Account Holders.
16.4 Khartoum Stock Exchange.
16.5 General Public.

17- Subsequent significant events, as of bank's statement of financial position date, should be disclosed to the following users:
17.1 Shareholders.
17.2 Investment Account Holders.
17.3 Current Account Holders.
17.4 Khartoum Stock Exchange.
17.5 General Public.

18- Nature and the amount of the bank's assets which are restricted for a particular use or used as a collateral for its obligation should be disclosed to the following users:
18.1 Shareholders.
18.2 Investment Account Holders.
18.3 Current Account Holders.
18.4 Khartoum Stock Exchange.
18.5 General Public.
19- Nature and effects of the bank's accounting policies changes should be disclosed to the following users:
19.1 Shareholders.
19.2 Investment Account Holders.
19.3 Current Account Holders.
19.4 Khartoum Stock Exchange.
19.5 General Public.
20- The method that was used by the bank to allocate investment profits or (losses) between unrestricted investment account holders and the bank's as *Mudarib* should be disclosed to the following users:
20.1 Shareholders.
20.2 Investment Account Holders.
20.3 Current Account Holders.
20.4 Khartoum Stock Exchange.
20.5 General Public.

21- The bank's related parties transactions should be disclosed to the following users:

21.1 Shareholders.

21.2 Investment Account Holders.

21.3 Current Account Holders.

21.4 Khartoum Stock Exchange.

21.5 General Public.

Table 7.1 shows that the total of 735 usable responses were received from the seven banks.

Table 7.1: Bank MGRs' responses to question 2 in Section A

Bank	**Respondent**	**Responses Sent**	**Received**	**Usable responses**	**Response rate %**
Alpha	1	105	105	105	100
Beta	1	105	105	105	100
Zubra	1	105	105	105	100
Frasa	1	105	105	105	100
Hadatha	1	105	105	105	100
Sayada	1	105	105	105	100
Asdar	1	105	105	105	100
Total	7	735	735	735	100

Table 7.2 presents a summary of the main findings of the empirical work concerning bank MGRs' opinions on the implementation of the standards[37]

Table 7.2: Bank MGRs' opinions about the implementation of the standard

Bank	**Bank class**	SA	A	N	D	SD	Total replies
Alpha	Public	20	22	20	28	15	105
Zubra	Public	-	51	32	22	-	105
Frasa	Public	11	46	27	21	-	105
Beta	Private	78	12	13	2	-	105
Hadatha	Private	43	62	-	-	-	105
Sayada	Private	10	37	58	-	-	105
Asdar	Foreign	55	9	2	37	2	105
	total						735

SA= Strongly agree, A= Agree, N= Neutral, D= Disagree, SD= Strongly disagree

For statistical analysis "strongly agree" and "agree" are combined into positive response and "strongly disagree" and "disagree" are combined into negative responses because the number of banks in Sudan is limited.

[37] The author's own computation.

7.3 The analysis of bank MGRs' opinions on the standard

7.3. 1 Overall Findings

Table 7.3 shows that more positive opinions are received from MGRs of private banks (76.8) on the implementation of the standard than the MGRs of public and foreign banks (47.5%, 60.9%, respectively). On the negative side, it can be seen that there are significantly more negative opinions from MGRs' of public and foreign banks.

Table 7.3: Bank MGRs' opinions on the implementation of the standard according to bank's class[38]

Bank's class	Positive		Neutral		Negative		Total	
	Responses	%	Responses	%	Responses	%		%
Public	42	40	20	19	43	41	105	100
Public	51	49	32	30	22	21	105	100
Public	57	54	27	26	21	20	105	100
Sub total	150	47,6	79	25.1	86	27.3	315	100
Private	90	86	13	12	2	2	105	100
Private	105	100	-		-		105	100
Private	47	45	58	55	-		105	100
Sub total	242	76.8	71	22.5	2	0,7	315	100
Foreign	64	60.9	2	0.1	39	37	105	100

[38] The author's own computation.

7.3.2 Bank MGRs' opinions on conveying information for the perceived needs of the users of the bank's financial statements

Table 7.4 present a summary of the main findings of the empirical work relating to banks MGRs' responses to conveying information for the perceived needs of the main users of Islamic banks' financial statements.

Table 7.4: Bank MGRs' responses to convoying the perceived information need of users

Main users	Bank MGRs' responses					Total
	SA	A	N	D	SD	
SH	103	37	7	-	-	147
KSE	22	48	33	40	4	147
IAH	59	50	22	16	-	147
CAH	40	41	45	21	-	147
GP	17	49	36	32	13	147

SH= Shareholders, KSE= Khartoum Stock Exchange, IAH= Investment Account Holders CAH= Current Account Holders, and GP= General Public.

140 out of 147 of the MGRs responses i.e. 95% expressed positive opinions about disclosing accounting information to shareholders. This indicates that they have agreed to convey more information for the perceived information needs of the shareholders than other users. In other words the responses are significantly less positive for other categories of users, including IAHs (See Figure 7 below).

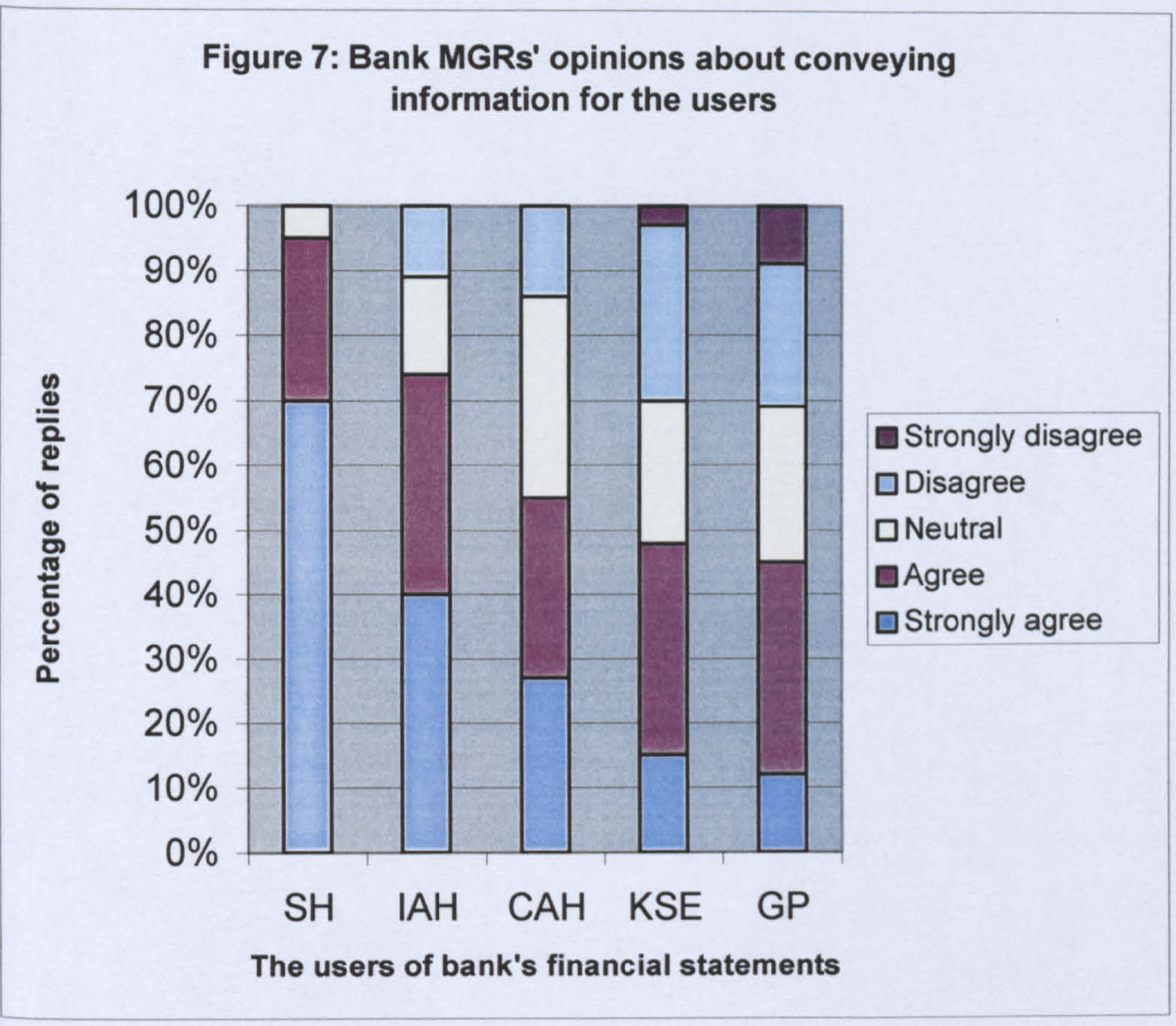


Figure 7: Bank MGRs' opinions about conveying information for the users
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Percentage of replies
SH
IAH
CAH
KSE
GP
The users of bank's financial statements
Strongly disagree
Disagree
Neutral
Agree
Strongly agree

7.4 Factors associated with the opinions of the MGRs on the standard

Due to the small number of the banks (studied) in Sudan,[39] the independent variables are treated separately and dichotomously. The dichotomised variables are (a) the cost of compliance; large/small (number of branches); and (b) the listing status; listed/ non-listed banks.

7.4.1 Cost of compliance (bank's number of branches) with the standard

a- Descriptive statistics

Table 7.5 shows that MGRs of banks with a larger number of branches have less positive attitudes towards, and opinions (44.4 %) on, the implementation of the standard than those of banks with a smaller number of branches (75.2 %). One the neutral and negative sides, it can be observed that there are substantially more neutral and negative opinions from MGRs of banks with a larger number of branches.

Table 7.5 Summary of positive neutral and negative responses according to bank's number of branches (see Table 6.3, column 9 above)

Bank	Bank's class	Positive Responses	%	Neutral Responses	%	Negative Responses	%	Total	%
Alpha	Larger	42	40	20	19	43	41	105	100
Zubra	Larger	51	49	32	30	22	21	105	100
Sayada	Larger	47	45	58	55	-		105	100
	Sub total	140	44.4	110	34.9	65	20.6	105	100
Frasa	Smaller	57	54	27	26	21	20	105	100
Beta	Smaller	90	86	13	12	2	2	105	100
Hadata	Smaller	105	100	-		-		105	100
Asdar	Smaller	64	61	2	2	39	37	105	100
	Sub total	318	75.2	42	10.1	62	14.7	420	100

[39] The total number of the selected banks was 7 out of 28, for more details see chapter 6 section 6.6 above.

b- Statistical analysis

Chi-square test (X^2= 85.16 df = 2) indicates that the null hypothesis [i.e., there is no difference in MGRs' opinions between banks with a larger number of branches and banks with smaller number of branches on the implementation of the standard] can be rejected at the .05 level[40] (See Table 7.9 below). Therefore, the cost of compliance proposition (P1) is supported.

c. The evaluation of costs of compliance with the standard

Question 3 in Section A: Items 1-3

3- What is the likelihood that the bank's financial statements, which are prepared, in accordance with AAOIFIs' FAS 1, would involve the following additional costs.
Creating additional cost in monetary terms.
Increasing the work load of the concerned bank staff.
Increase the need for more training and educational courses.

Question 3 in section A aimed to elicit bank MGRs' opinions about the evaluation of additional cost associated with the implementation of AAOIFI's disclosure standard. Descriptive statistics are only used to analyze the data. Because, there is a problem of measuring statistical test of significance with small number of observations regarding bank's MGRs' evaluation of cost of compliance.

Table 7.6 presents the findings relating to the evaluation of the cost of compliance with the implementation of the standard. The table shows that banks with larger number of branches evaluate the total costs of compliance (in terms of money, effort and training) with the standard as very high, while banks with smaller number of branches rate the cost in terms of money and effort as high.

[40] The criteria for significance are those adopted as standard in this type of accounting research.

Table 7.6: The evaluation of the cost of compliance with the standard

Bank	Bank's size (branches)	Cost of compliance with the standard		
		Money	Effort	Training
Alpha	Larger	5	5	5
Zubra	,,	5	5	5
Sayada	,,	5	5	5
Sub total		15	15	15
Average		5	5	5
Beta	Smaller	4	4	5
Frasa	,,	4	4	5
Hadatha	,,	*4*	*4*	*5*
Asdar	,	4	4	5
Sub total		16	16	20
Average		4	4	5

Where 5= very high, 4= high, 3= moderate, 2= low and 1= very low

7.4.2 Benefits associated with the implementation of the standard

The Listing status[41]

Table 7.7 presents the findings of the empirical work concerning bank MGRs' responses (excluding their responses to conveying information to KSE.) to the implementation of the standard.

[41] Responses to conveying information, in accordance with the standard, to KSE are excluded from the analysis of listing status variable, because these responses are perceived to inflate the result since banks are dichotomized as listed and non-listed.

Table 7.7: Bank MGRs' responses to the implementation of the standard according to bank's status (see Table 6.3, column 10 above)

Bank	Bank's status	SA	A	N	D	SD	Total replies
Alpha	Non-listed	20	19	19	14	12	84
Zubra	Non-listed	-	47	19	18	-	84
Asdar	Non-listed	55	8	12	8	1	84
	Sub total	75	74	50	40	13	252
Beta	Listed	61	10	11	2	-	84
Frasa	Listed	11	42	14	17	-	84
Hadatha	Listed	42	42	-	-	-	84
Sayada	Listed	9	30	45	-	-	84
	Sub total	123	124	70	19	-	336
	total	198	198	120	59	13	588

SA= Strongly agree, A= Agree, N= Neutral, D= Disagree, SD= Strongly disagree

For statistical analysis "strongly agree" and "agree" are combined into positive responses and "strongly disagree" and "disagree" are combined into negative responses because the number of the selected banks in Sudan is limited.

a- Descriptive statistic

Table 7.8 indicates that MGRs of listed banks on the KCE have more positive attitudes towards, and opinions (74%) on, the implementation of the standard than those of non-listed banks (59%). On the negative side it can be seen that there are substantially more negative opinions from the MGRs of non listed banks

Table 7.8: Banks' listing status and MGRs' opinions about the implementation of the standard

Bank	Bank's status	Positive Responses	%	Neutral	%	Negative Responses	%	Total	%
Alpha	Non-listed	39	46	19	23	26	31	84	100
Zubra	Non-listed	47	56	19	23	18	21	84	100
Asdar	Non-listed	63	75	12	14	9	11	84	100
	Sub total	149	59.1	50	19.8	53	21.1	252	100
Beta	Listed	53	63	14	17	17	20	84	100
Frasa	Listed	71	85	11	13	2	2	84	100
Hadatha	Listed	84	100	-	-	-	-	84	100
Sayada [42]	Listed	39	46	45	54	-	-	84	100
	Sub total	247	73.5	70	20.8	19	5.7	336	100
	Total	396		120		72		588	

[42] *Sayada* bank is listed on KSE and also has a larger number of branches, (See table 6.3 above).

b- Statistical analysis

Chi square test (X^2= 32.28, df=2) shows that the null hypothesis could be rejected at the .05 level. Therefore, there is a significant difference in the opinions of MGRs, between listed and non-listed banks, on the implementation of the standard (See Table 7.9 below). Therefore, the listing status proposition (P2) is supported.

Table 7.9: Chi-square analysis of independent variables relating to MGRs' opinions about the standard[43]

Independent Variables and statistics	X^2	Critical value P= 0.05, df=2	Result
Listing status (listed/non-listed bank)	32.28	5.99	Significant
Cost of compliance (large/small No. of branches)	85.16	5.99	Significant

[43] The author's own computation, (See Appendix 14 and 15)

7.5 Banks' actual compliance with the standard[44]

It is worth noting that in 1998 the CBS ordered all Islamic banks in Sudan to comply with the standard. Table 7.2 presents a summary of the actual implementation of the standard.

Table 7.10: Banks' actual implementation of the standard as reflected in the 1998 annual reports

Bank name	Statement of financial position	Income statement	Cash flow statement	Statement of changes in owners' equity	Notes to the financial statement
Alpha	1	1	0	0	1
Beta	2	2	2	2	2
Zubra	1	1	0	0	1
Frasa	1	2	0	0	1
Hadatha	2	2	2	2	1
Sayada	2	2	0	2	1
Asdar	2	2	0	0	1

Fully implemented = 2, partially implemented = 1, Not implemented = 0

7.5.1 Bank's number of branches

Table 7.11 shows that banks with a larger number of branches have less compliance with the standard (20%) than banks' with a smaller numbers of branches (60%). According to the Chi-square test the difference between the two groups is significant at 0.10 level (See Table 13 below).

[44] Applicable financial statements are four out of seven, which include statement of financial position, income statement, statement of cash flows and statement of changes in owners' equity. In addition to the notes to financial statements..

Table 7.11: Banks' actual implementation of the standard according to bank's size

Bank name	Bank's size	Fully implemented	Partially implemented	Not implemented	Total
Alpha	Larger	-	3	2	5
Zubra	,,	-	3	2	5
Sayada	,,	3	1	1	5
Sub total		3	7	5	15
%		20	47	33	100
	Smaller				
	,,	1	2	2	5
Frasa	,,	5	-	-	5
Beta	,,	4	1	-	5
Hadatha		2	1	2	5
Asdar					
Sub total		12	4	4	20
%		60	20	20	100

7.5.2 Bank's listing status

Table 7.12 indicates that banks listed on KSE have more compliance with the requirements of the standard (65%)than non-listed banks (13%). According to the Chi-square test the difference between the two groups is significant at 0.05 level (See Table 13 below).

Table 7.12: Banks' actual implementation of the standard according to bank's listing status

Bank name	Bank's status	Fully implemented	Partially implemented	Not implemented	Total
Alpha	Non-listed	-	3	2	5
Zubra	,,	-	3	2	5
Asdar	,,	2	1	2	5
Sub total		2	7	6	15
%		13	47	40	100
Frasa	Listed	1	2	2	5
Beta	,,	5	-	-	5
Hadatha	,,	4	1	-	5
Sayada	,,	3	1	1	5
Sub total					
%		13	4	3	20
		65	20	15	100

Table 7.13: Chi-square analysis of independent variables[45] relating to the actual implementation of the standard

Independent Variables and statistics	X^2	Critical value P= 0.05, 0.10 df=2	Result
Listing status (listed / non-listed bank)	9.36	5.99	Significant at 0.05 level
Cost of compliance (larger/ smaller No. of branches)	5.73	4.60	Significant at 0.10 level

[45] The author's own computation, (See Appendix 16 and 17).

7.6 Discussion of the findings

The analysis carried out on the attitudes and opinions of the MGRs on, and actual compliance with, the disclosure standard has produced the following findings.

1- The overall percentages of positive opinions received from the respondents (Section 7.3.2 above) indicate that the bank MGRs' perceived the information needs of shareholders (95% positive) as more important than of other users. For example, the corresponding percentage for IAHs was 74%. Such a situation may not be acceptable to the investment account holders (IAHs) who invest on a system of profit-and-loss sharing and are thus, a type of equity investors. Unlike shareholders, IAHs have no right to interfere with the management of the bank, and no right to appoint or dismiss members of the board of directors and the EAs. If IAHs are faced with poor financial results they can only withdraw their funds to be invested elsewhere i.e. they can only vote with their feet. (See Archer et al, 1998, p. 165).

2- Descriptive statistics (See Sub-section 7.4.1.a above) show that MGRs of banks with a larger number of branches tend to have less positive attitudes towards, and opinions on, the implementation of the standard than those of banks with a smaller number of branches. Furthermore, the Chi-square test indicates that this difference is statistically significant (see sub-section 7.4.1b above). Therefore, the result supports the cost of compliance proposition (P1 in chapter 5 above) that MGRs of banks with a larger number of branches will have less positive attitudes towards, and opinions on, the implementation of the standard than MGRs of banks with a smaller number of branches.

3- Descriptive analysis also indicates that MGRs of banks listed on the KSE tend to have more positive attitudes towards, and opinions on, the implementation of the standard than the MGRs of non-listed banks. The Chi- square test shows that this difference is statistically significant (see section 7.4.2. above). Hence, the findings provide adequate support for the listing status proposition (P2 in Chapter 5 above) that listed banks will have more positive attitudes towards, and opinions on, the implementation of the standard. This finding is consistent with the findings of the studies of Leftwich et al. (1981), Singhavi and Desais (1974) and Frost and Pownal (1999).

4- The results also indicate that the less positive attitudes and opinions received from the MGRs of banks with large numbers of branches and from those of non– isted banks are confirmed by a low level of disclosure in their banks' financial statements (See Sections 7.5.1 and 7.5.2 above).

5- Based on interviews with the general MGRs of the banks or their deputies, it is evident that six out of seven banks disagreed with the implementation of the disclosure of (a) unusual supervisory restrictions imposed by the CBS[46] and (b) transactions with related parties. As an example, the Deputy General MGR of Alpha Bank expressed the view that the disclosure of a central bank's restriction on the bank's activity would have a negative effect on the bank's competitive position with other banks and/or similar institutions. With regard to the bank's transactions with related parties, the Deputy General MGR of Beta bank commented: 'such disclosure to the general public leads to an infringement of the privacy of related parties'.

6- As for training issues, all the MGRs of banks included in the present study rate training costs as very high. Moreover, in discussions and meetings with the Deputy General MGR of Alpha Bank, he said: "our staff badly needs training for Islamic accounting standards, in particular the disclosure standard". It was also observed that the concerned staff working for Alpha, Zubra and Asdar have had less experience than what is required by the standard. This indicates a pressing need for training courses and workshops for the staff working for those banks.

7- With regard to other costs of compliance in terms of money and effort, almost all the MGRs of banks with a larger number of branches evaluate such costs as very high.

[46] The CBS can impose restrictions on a commercial bank's investments.

Additionally, the MGRs thought that the preparation of their banks' financial statements, in accordance with the AAOIFI's FAS 1, would financially involve high costs. When asked about the cost implications of implementing the standard, the Deputy General MGRs of Beta and Frasa Banks expressed the view that "the cost would be high for the first two years of the implementation but no more than that".

8- It is observed that the annual reports for 1998 of the compilers indicate differences in accounting policies used and their level of disclosure. It follows that there is no single set of accepted accounting policies to which users might refer; and the diverse accounting policies that are available for adoption would produce different sets of financial statements based on the same events and conditions. The following are examples of items in which different accounting policies exist and, therefore, require disclosure.

- Methods of allocation of profits between the Islamic bank and IAH.
- Consolidation policy
- Translation of foreign currency, including the disposition of exchange gains and losses.
- Provisions and reserves.

7. Summary and concluding remarks

The overall percentage of responses received from all MGRs of banks included in the study indicates that bank MGRs perceived the information needs of shareholders more clearly than those of others users of financial statements. This raises the issue of how to protect the interests of other users of the bank's financial statements such as IAH. The number of branches is used as a variable representing the cost of compliance with the standard. The variable is found to be statistically significantly associated with attitudes and opinions of banks MGRs on the implementation of the standard. This indicates that the number of branches is the dominant factor in explaining the significant variation in banks MGRs' attitudes towards, and opinions on, the implementation of the standard. Therefore, the cost of compliance proposition (P1), in chapter 5 above is supported, showing that attitudes towards, and opinions on, such standard are driven by similar variable in Sudan as they are in Western countries (e.g., USA).

Although the Khartoum stock exchange (KSE) in Sudan is an emerging market, the banking sector's shares (which is predominant by privately-owned banks) are actively traded on KSE and its 2000 annual report proves this. The listing status variable is also found to be statistically significantly associated with the banks' attitudes towards, and opinions about, the implementation of the standard. It follows that the listing status is an important factor in explaining the significant differences in banks' opinions on the implementation of the standard. Hence, the listing status proposition (P2) is supported. This finding is consistent with findings of the study of Leftwich et al. (1981), Singhavi and Desais (1974) and Frost and Pownal (1994). Therefore, the attitudes and opinions of bank MGRs in Sudan are explained by the listing status variable, as they are in the USA and in some cases in the UK.

In conclusion, banks MGRs' attitudes towards, and opinions on, the implementation of the standard are largely influenced by cost-benefit analysis. In addition, it was also observed that bank MGRs' opinions about the implementation of the standard are consistent with their actual compliance with the standard. For instance, banks with a smaller number of branches have more positive attitudes towards, and opinions about, the implementation of the AAOIFI's standard, and simultaneously comply more with the standard than banks with a larger number of branches. Thus, the expressed opinions of MGRs provide a reliable indicator of their attitudes towards the implementation of the standard.

In short, banks' views on, and their actions to, the implementations of the standard are influenced by cost– benefit considerations. In other words enthusiastic banks perceive the potential benefits as greater than the potential costs; whereas non-enthusiastic banks perceive the cost of compliance as greater than potential benefits. Hence, the number of branches and listing status are the most important factors explaining differences in bank MGRs' attitudes towards, and opinions on, the implementation of the standard as they are those used by the US firms in spite of the differences between the two economic and political environments.

Chapter 8
Bank MGRs' Opinions on the Implementation of the Measurement Standards

8.1 Introduction and objective

In chapter 5 section 5.2.1 above, the following research question was developed to test the bonus plan proposition (P3), the ownership proposition (P4) and the size proposition (P5).
To what extent do Islamic banks display positive or negative attitudes towards, and opinions on, the implementation of AAOIFI's accounting standards?

The following specific question was then addressed.
How much do bank MGRs agree or disagree in their attitudes towards, and opinions on, the implementation of AAOIFI's measurement standards?
This specific question was followed by more specific itemized questions (62 items) were asked in order to elicit the opinions of respondents (banks' MGRs) on the requirements of the measurement standards[47] (See Appendix 7-11).

As mentioned in chapter 5 section 5.3 above, a single (embedded) case study approach, with cross-sectional comparisons of sub-units of analysis, is used to test whether the theoretical propositions, derived from the existing research literature, fit the data. These theoretical propositions pertain to bank MGRs' opinions on the implementation of the measurement standards (hereafter referred to as the standards). They include the bonus plan proposition (P3), ownership proposition (P4) and size (value of total assets) proposition (P5).

The main purpose of this chapter is thus, to analyze and discuss the findings of the single (embedded) case study relating to bank MGRs' opinions on the implementation of the standards.

[47] Measurement standards include standards on *Murabaha, Mudaraba, Musharaka, Salam* and Equity of Investment Account Holders.

The remainder of the chapter is set out as follows:

Section 2 presents the main findings of the empirical study on bank MGRs' responses to the implementation of AAOIFI's measurement standards. Section 3 provides a descriptive analysis of the opinions of bank MGRs on the implementation of the standards. Section 4 tests the propositions derived from the existing literature review, namely bonus plan proposition (P3) ownership (public/private) proposition (P4) and size (value of total assets) proposition (P5). Section 5 evaluates the need for training courses of implementing the standards for the staff working for the banks. Section 6 discusses the main findings of the case study. Section 7 provides summary and concluding remarks.

8.2 The main findings of the bank MGRs' responses to the implementation of the standards

Question 2b relates to MGRs' opinions on the requirements of the standards

Table 8.1 shows that 398 usable responses were received from the respondents of the selected banks

Table 8.1: Banks MGRs' responses to question 2b (questions 2 in sections [B1-B5])

Bank	Bank class	responses	Received	usable responses	response rate %
Alpha	Public	62	62	62	100
Zubra	,,	62	62	62	100
Frasa	,,	62	62	62	100
Beta	Private	62	62	62	100
Hadatha	,,	62	62	62	100
Sayada	,,	62	62	62	100
Asdar	Foreign	26	26	26	100

Question 2 in Section B1: Items 1-13

1	The assets possessed by the bank for the purpose of selling them on the basis of *Murabaha* or *Murabaha to the Purchase Orderer* shall be measured at the time of their acquisition on an historical cost basis.
2	Assets available for sale after acquisition on the basis of *Murabaha to the Purchase Orderer* who is obliged to fulfil his promise shall be measured at their historical cost. A decline in the assets value shall be reflected in the valuation of the assets at the end of each financial period.
3	If the bank finds that there is an indication of possible non-recovery of the costs of goods available for sale on the basis of *Murabaha* or *Murabaha to the Purchase Orderer* who is not obliged to fulfil his promise, the asset shall be measured at the cash equivalent (i.e.net realizable) value. This shall be achieved by creating a provision for decline in the asset value to reflect the difference between acquisition cost and the cash equivalent value.
4	If the bank obtains a discount on the asset available for sale on the basis of *Murabaha to the Purchase Orderer*, such discount shall not be considered as revenue for the bank. Instead, the cost of the relevant goods shall be reduced by the amount of the discount.
5	The discount may, however, be treated as revenue for the bank if this is decided by *Shria*' supervisory board of the bank. Such revenue shall be recognized in the income statement.
6	Short-term or long-term *Murabaha* receivables shall be recorded at the time of occurrence at their face value. *Murabaha* receivables are measured at the end of the financial period at their cash equivalent value (i.e., the amount of debt due from the customers at the end of the financial period less any provision for doubtful debts).
7	Profits from *Murabaha* or *Murabaha to the Purchase Orderer* are recognized at the time of contracting if the sale is for cash or on credit not exceeding the current financial period.
8	Profits of a credit sale, which will be paid for either by means of one payment due after the current financial period or by installments over several future financial periods, shall be recognized by proportionate allocation of profits over the period of the credit. Whereby each financial period shall carry its portion of profits irrespective of whether or not cash is received.
9	As and when the installments are received. This method shall be used based on a decision made by *Shari'a* supervisory board of the bank, or ,if it is required by, supervisory authority.
10	The amount paid as *hamish gedyyah* is considered an obligation on the bank and shall be treated as a liability unless the *Shari'a* supervisory board of the Islamic bank decides otherwise.
11	The amount of *hamish gedyyah* is returned in full even if the asset is sold to another client at a lower price than that agreed upon by the client who was the original purchase orderer.
12	In the case of binding promise, the amount of actual loss shall be deducted from *hamish gedyyah*, (i.e., the bank shall not carry any losses).
13	If *hamish gedyyah* or other guarantees are not adequate or not available, any resultant loss to the bank shall be recorded as an amount due from the client provided there is evidence of his failure to fulfill his promise.

The questions in this section aimed to elicit the opinions of the banks' MGRs on the implementation of *Murabaha and Murabaha to the Purchase Orderer Standard.*

Based on the descriptive statistics used to analyze this section, it can be seen that 22% strongly agree, 51% agree, 13% neutral, 11% disagree and 3% strongly disagree (See Table 8.2 below).

Question 2 in Section B2: Items 1-14

1 *Mudaraba* financing capital (cash or kind) should be recognized when it is paid to the *Mudarib* or placed under his disposition.

2 If it is agreed that the capital of a *Mudaraba* is to be paid in installments, then each installment should be recognized at its payment.

Measurement of *Mudaraba* capital at the time of contracting:

3 *3 Mudaraba* capital provided in cash by the bank should be measured at the amount paid or the amount placed under the position of *Mudarib.*

4 *Mudaraba* capital provided in kind (trading assets) should be measured at the fair value of the assets (the value agreed between the bank and the client), and if the valuation of assets results in a difference between fair value and book value, such difference should be recognized as profit or loss to the bank.

5 *Mudaraba* capital after contracting should be measured as stated in item 2 and 3 above. However, any repayment of the *Mudaraba* capital, if any, made to the bank should be deducted from the *Mudaraba* capital.

6 If a portion of the *Mudaraba* capital is lost prior to the inception of work because of damage or other causes without any misconduct or negligence on the part of the *Mudarib*, then such loss should be deducted from the *Mudaraba* capital and should be treated as loss to the bank. However, if the loss occurs after inception of work, it should not affect the measurement of *Mudaraba* capital.

7 If the whole *Mudaraba* capital is lost without any misconduct or negligence on the part of the *Mudarib* the *Mudaraba* should be terminated and the account thereof should be settled and the loss should be treated as a loss to the bank.

8 If the *Mudaraba* is terminated or liquidated and the *Mudaraba* capital is not paid to the bank when a settlement of the account is made, the *Mudaraba* capital should be recognized as receivable due from the *Mudarib*..

9 Profits or loss in respect of the bank's share in *Mudaraba* financing transactions that commence and end during a single financial period should be recognized at the time of liquidation.

10 In the case of *Mudaraba* financing that continues for more than one financial period, the bank's share of profits for any period, resulting from partial or final settlement between the bank and the *Mudarib*, should be recognized in its accounts for that period to the extent that the profits are being distributed; the bank's share of losses for any period should be recognized in its account for that period to the extent that such losses are being deducted from the *Mudaraba* capital.

11 As implied in 8 above, if the *Mudarib* does not pay the bank its due share of profits after liquidation or settlement of account is made, the due share of profit should be recognized as receivable due from *Mudarib*.

12 Losses resulting from liquidation should be recognized at the time of liquidation by reducing the *Mudarib* capital.

13 The *Mudarib* should bear the losses incurred due to misconduct or negligence on his part. Such loss should be recognized as a receivable due from the M*udarib*.

14 Disclosure should be made in the notes to the financial statements for a financial reporting period if the bank has made during the period a provision for decline in the value of *Mudaraba* assets.

The questions in this section aimed to elicit the opinions of the banks' MGRs on the implementation of *Mudaraba Financing* Standard.

Based on the descriptive statistics used to analyze this section, Table 8.2 below shows that 60% strongly agree, 21% agree, 17% neutral and 2% disagree.

Question 2 in Section B3: Items 1-13

1 The bank's share in *Musharaka* capital (cash or kind) should be recognized when it is paid to the partner or made available to him on account of the *Musharaka.*

2 The bank's share in *Musharaka* capital provided in cash should be measured by the amount paid or made available to the partner on the account of the *Musharaka.*

3 The bank's share in *Musharaka* capital provided in kind (trading assets) should be measured at the fair value of the assets (the value agreed between the partners) and if the valuation results in a difference between fair value and book value, such difference should be recognized as a profit or loss to the bank. .

4 The bank's share in the constant *Musharaka* capital should be measured at the end of the financial period at historical cost.

5 The bank's share in the diminishing *Musharaka* should be measured at the end of the period at historical cost after deducting from the historical cost of any share transferred to the partner (such transfer being by means of a sale at fair value) the difference between historical cost and fair value should be recognized as profit or loss in the bank's income statement.

6 If the diminishing *Musharaka* is liquidated before complete transfer is made to the partner. The amount recovered in respect of the bank's share should be credited to the bank's *Musharaka* financing account and any resulting profit or loss, namely the difference between the book value and the recovered amount, should be recognized in the bank's income statement.

7 If the *Musharaka* is terminated or liquidated and the bank's due share of the *Musharaka* capital remains unpaid when a settlement of account is made, the bank's share should be recognized as receivable due from the partner.

8 Profits or losses in respect of bank's share in *Musharaka* financing transactions that commence and end during a financial period should be recognized in the bank's account at the time of liquidation.

9 In the case of a constant *Musharaka* that continues for more than one financial period, the bank's share of profits for any period, resulting from partial or final settlement between the bank and the partner, should be recognized in its accounts for that period to the extent that the profits are being distributed, the bank's share of loss for any period should be recognized in its accounts for that period to the extent that such losses are being deducted from its share of the *Musahraka* capital.

10 Item .9 should apply to a diminishing *Musharaka* which continues for more than one financial period, after taking into consideration the decline in the bank's share in *Musharaka* capital and its profits or losses.

11 If losses are incurred in *Musharaka* due to the partner's misconduct or negligence, the partner should bear the bank's share of such losses; such losses should be recognized as receivable due from the partner.

12 The bank's unpaid share of the proceeds should be recorded in a *Musharaka* receivable accounts. A provision should be made for these receivables if they are doubtful.

13 Disclosure should be made in the notes to the financial statements for a financial-reporting period if the bank has made during the period a provision for a loss of its capital in *Musharaka* financing transactions

The questions in this section aimed to elicit the opinions of the banks' MGRs on the implementation of *Musharaka Financing* Standard.

Based on the descriptive statistics used to analyze this section, Table 8.2 below indicates that 27% strongly agree, 59% agree, 8% neutral and 6% disagree.

Question 2 in Section B4: Items 1-10

1	Equity of unrestricted investment account holders should be measured by the amount received by the bank at the time of contracting.
2	At the end of financial period, equity of unrestricted investment account holders should be measured at their book value.
3	Profits of an investment jointly financed by the bank and unrestricted investment accounts holders should be allocated between them according to the contribution of each of the two parties in the jointly financed investment.
4	Loss resulting from transactions in a jointly financed investment (that is recognized during a period other than that in which final settlement of the investment account is made) should in the first instance be deduced from any undistributed profits on the investment.
5	Any such loss in excess of the amount of undistributed profits should be deducted from provisions for investment losses formed for this purpose. The remaining loss, if any, should be deduced from the respective equity shares in the joint investment of the bank and the unrestricted investment accounts holders, according to each party's contribution to the joint investment.
6	Loss due to misconduct or negligence on the part of the bank, based on the opinion of the *Shari'a* supervisory board of the bank, should be deducted from the bank's share in the profits of the jointly financed investment. In case the loss exceeds the bank's share of profits the difference should be deduced from its equity share in the joint investment, if any, or recognized as due from the bank.
7	Assets and liabilities relating to equity of restricted investment account holders and their equivalent should be treated separately from the bank's assets and liabilities.
8	Equity of restricted investment accounts holders should be measured by the amount received by the bank or the client's purchase price of the units or shares brought by him at the time of contracting.
9	At the end of financial period, equity of restricted investment account holders should be measured at its book value.
10	In the case the bank has funds invested in restricted investment accounts whether from its own equity or from other funds at its disposal, the bank should share in the profits earned on such funds in its capacity as provider of funds.

The questions in this section aimed to elicit the opinions of the banks' MGRs on the implementation of Equity of Investment Account Holders Standard.

Based on the descriptive statistics used to analyze this section, Table 8.2 shows that 30% strongly agree, 62% agree and 8% neutral.

Question 2 in Section B5: Items 1-12

1	*Salam* financing shall be recognized when the capital of *Salam* is paid (whether in cash, kind or benefit) to al *muslam ileihi* or when it is made available to him.
2	Parallel *Salam* transactions shall be recognized when the bank receives the capital of *Salam* (in cash, kind or benefit).
3	The capital of *Salam* shall be measured by the amount paid at the time of contracting.
4	Capital of *Salam* provided in kind, or benefit shall be measured at the fair value (the value agreed between the bank and the client) of the asset or provided benefit.
5	The capital of *Salam* is measured at the end of a financial period as in item 4. However, if it is probable that *al-muslam ileihi* will not deliver *al-muslam fihi* in full or in part, or it is probable that the value of *al-muslam fihi* will decline, the bank shall make a provision of the amount of the estimated deficit.
6	Assets constitutive of *al-muslam fihi* received by the bank in accordance with contract are recorded at their historical cost.
7	If the market value (or the fair value if the market value is not available) of the received *al-muslam fihi* is equal to the value of contract *al muslam fihi*, the received *al-muslam fihi* shall be measured and recorded at book value.
8	If the market value of the received *al-muslam fihi* is lower than the book value of contracted *al-muslam fihi*, the received *al- musalm fihi* shall be measured and recorded at market value (or fair value) at the time of delivery and the difference shall be recognized as loss.
9	If the *Salam* financing contract is completely or partially cancelled and the client has failed to repay the capital of *Salam* or the required portion thereof, the amount due shall be recognized as receivable due from the client.
10	In case the bank has securities pledged for *al-muslam fihi* and the profits from the sale of the securities are less than the book value, the different is recognized as a receivable due from the client. Alternatively, if the proceeds are less than the book value then the difference is credited to the client.
11	At the end of a financial period, assets acquired through *Salam* financing shall be measured at the lower of historical cost and cash equivalent value, and if the cash equivalent value is lower, the difference shall be recognized as loss in the income statement.
12	Upon delivery of *al muslam fihi* by the bank to the client in a parallel *Salam*, the difference between the amount paid by the client and the cost of *al-muslam fihi* shall be recognized as profit or loss.

The questions in this section aimed to elicit the opinions of the banks' MGRs on the implementation of *Salam and Parallel Salam Financing* Standard.

Based on the descriptive statistics used to analyze this section, Table 8.2 below indicates that 26% strongly agree, 61% agree, 6% neutral, 6%. Disagree and 1% strongly disagree

Table 8.2 presents the main findings relating to the opinions of MGRs on the implementation of the standards.

Table 8.2: The findings of bank MGRs' opinions on the implementation of individual standards

measurement standards / managers' opinions	SA	%	A	%	N	%	D	%	SD	%	Total
Murabaha	20	22	46	51	12	13	10	11	3	3	91
Mudaraba	50	60	18	21	14	17	2	2	-	-	84
Musharaka	25	27	54	59	7	8	5	6	-	-	91
Salam	19	26	44	61	4	6	4	6	1	1	72
Equity of investment account holders	18	30	37	62	5	8	-	-	-	-	60

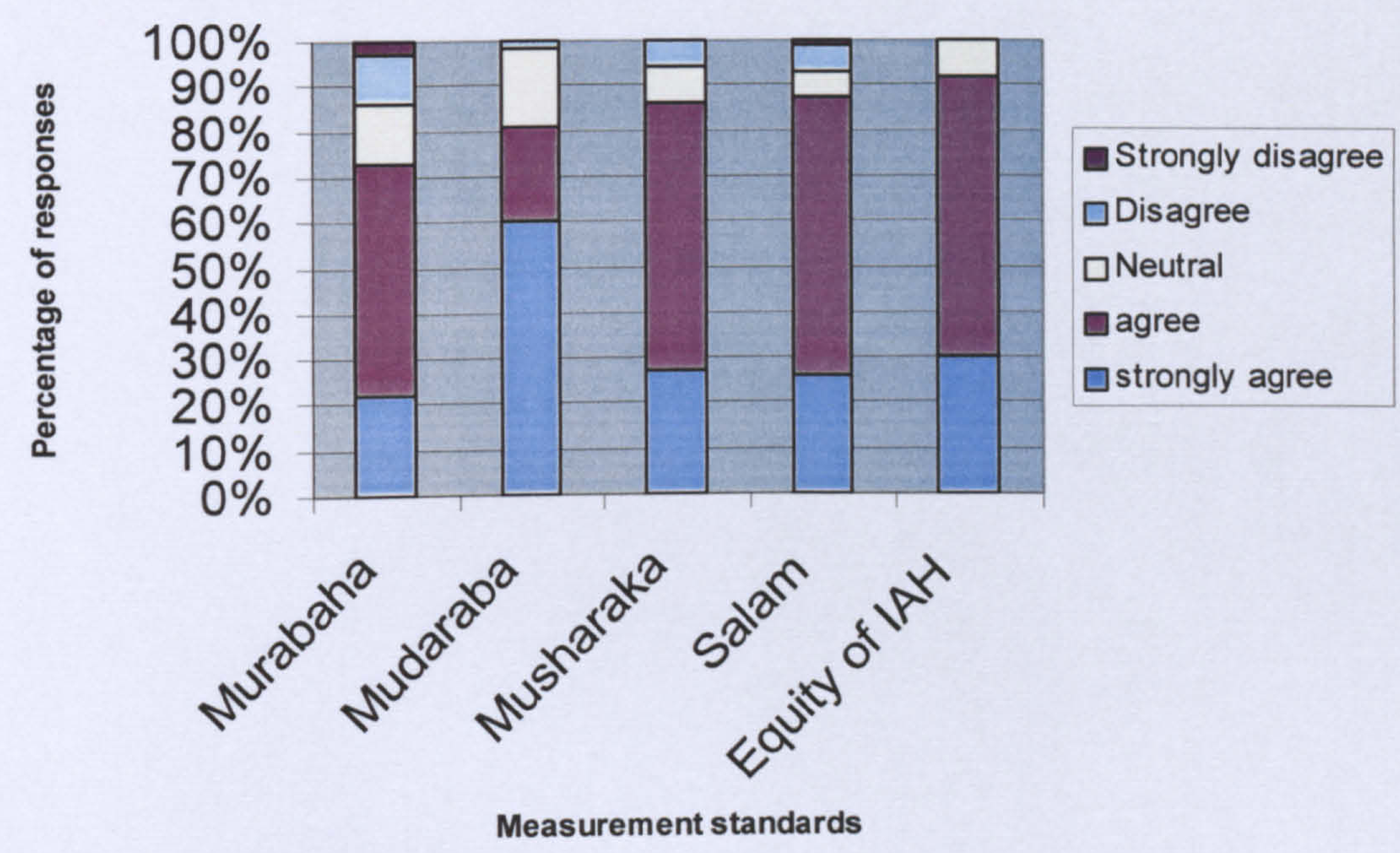
SA= Strongly agree, A= Agree, N= Neutral, D= Disagree, SD= Strongly disagree

8.3 Overall analysis of bank MGRs' responses to the implementation of the standards

Overall bank MGRs' opinions on the standards

Figure 8 shows that all most MGRs of banks have positive attitudes towards, and opinions about, the implementation of the standards, with few negative opinions.

Figure 8: Bank MGRs' opinions on individual measurement standards



8.4 Factors influencing bank MGRs' opinions on the implementation of the standards[48]

As mentioned in chapter 7 above, because of the small number of selected banks, the independent variables are treated separately and dichotomously. The cross-sectional comparison with the Chi-square contingency table test is used in order to test whether the value of the dichotomised variables has a significant association with that of the dependent variable. The dichotomised variables are (a) ownership; (public/private); (b) the existence (non-existence) of a bonus plan; and (c) bank's size (value of total assets). It was discovered that one of these dichotomised variables is co-extensive with another, In effect, all private banks have a bonus plan but no public bank has.

Table 8.3 presents the main findings of the empirical study relating to the banks MGRs' opinions on the implementation of the measurement standards according to bank's class.

Table 8.3: The findings of bank MGRs' opinions on the implementation of measurement standards according to bank's class (see Table 6.3, column 2)

Bank class	SA	A	N	D	SD	Total
Public banks (with no bonus plans)	59	65	22	38	2	186
Private banks (with bonus plan)	75	80	25	4	2	186
Foreign bank (with bonus plan)	2	17	4	3		26

SA= Strongly agree, A= Agree, N= Neutral, D= Disagree, SD= Strongly disagree

[48] The implementation of the measurement standards by the selected (studied) banks is not observed hence, the opinions of respondents are only used as indication of their attitudes.

For statistical analysis "strongly agree" and "agree" are combined into positive response and "strongly disagree" and "disagree" are combined into negative responses because the number of banks in Sudan is limited. Moreover, private and foreign banks are combined into private banks.

Table 8.4 presents the summary of positive, neutral and negative responses

Table 8.4: Summary of positive, neutral and negative responses

Bank's class	**Positive**	**Neutral**	**Negative**	**Total**
Public banks (with no bonus plan)	124	22	40	186
Private banks (with bonus plan)	174	29	9	212

8.4.1 Ownership (public/private)/Bonus plan variable

a) Descriptive statistics analysis

Based on the descriptive statistics used , table 8.5 shows that MGRs of private banks (with bonus plans) have more positive attitudes towards, and opinions on [82%], the implementation of the measurement standards than MGRs of public banks (with no bonus plans) [66%]. On the neutral and negative sides it can be observed that there are substantially more negative opinions from the MGRs of public banks (with no bonus plans).

Table 8.5: Descriptive statistics of bank's ownership (bonus plans) variable

Bank's class	**% of responses**		
	Positive	**Neutral**	**Negative**
Public banks (with no bonus plans)	66	12	22
Private banks (with bonus plans)	82	14	4

b) Statistical tests

A Chi- square test (X^2= 26.94, df= 2) indicates that there is a significant difference in bank MGRs' opinions (See Table 8.8 below) on the implementation of the standards. In other words,. MGRs of public banks express significantly more negative opinions on the implementation of the standards than MGRs of private banks. Thus, the results provide support for the public/private proposition (P4 in chapter 5 above). The bonus plan variable happens, however, to be co-extensive with another independent variable (i.e. public/private). In any case the bonus plan proposition is that MGRs of banks with bonus plans will be less positive in their attitudes towards, and opinions on, the measurement standards. Thus, the results provide no support for the bonus plan hypothesis in Sudan.

8.4.2 Bank size (total assets)

Table 8.6 presents the summary of positive, neutral and negative responses

Table 8.6: Summary of positive, neutral and negative responses according to bank size (see Table 6.3, column 3)

Bank's size	Positive	Neutral	Negative	Total
Banks with larger value of total assets	108	39	39	186
Banks with smaler value of total assets	190	12	10	212

a. Descriptive statistics analysis

Table 8.7 indicates that MGRs of banks with a larger value of total assets have a less positive attitudes towards, and opinions (58 %) on, the implementation of measurement standards as compared to MGRs of a smaller value of total assets (89%). On the neutral and negative sides there are more negative opinions from the MGRs of banks with larger value of total assets.

Table 8.7: Descriptive statistics of bank's size (value of total assets) variable

Bank's size	% of responses		
	Positive	Neutral	Negative
Banks with larger value of total assets	58	21	21
Banks with smaller value of total assets.	89	6	5

b. Statistical analysis

A Chi square test (X^2= 52.54, df=2) indicates that there is a statistically significant difference in bank MGRs' attitudes towards, and opinions on, the implementation of the measurement standards. In other words, MGRs of banks with a larger value of total assets have significantly more negative attitudes towards, and opinions on, the implementation of the standards than MGRs of banks with a smaller value of total assets (See Table 8.8 below). The size hypothesis, namely that MGRs of banks with a larger value of total assets will have more negative attitudes towards, and opinions on, the implementation of the measurement standards than MGRs of banks with a smaller value of total assets, is therefore, supported by the data from Sudan.

Table 8.8: Chi-square analysis of independent variables relating to the implementation of the measurement standards [49]

Independent variables:	**Dependent variables: Opinions on the implementation of measurement standards**		
	X^2	Critical value	df
Ownership (bonus plan)	26.94	5.99	2
Bank size(total assets)	52.55	5.99	2

The critical value 5.9910 at the 0.05 level.

[49] The author's own computations, see Appendix 17 and 18.

8.5 The evaluation of the need for training courses

Question 3 in sections B1-5: Items 1-5

How do MGRs evaluate the need for training courses related to the implementation of the standards?
Murabaha and Murabaha to Purchase Orderer
Mudaraba Financing
Musharaka Financing
Salam and Parallel Salam
Equity of Investment Account Holders

Question 3 in sections B1-5 aimed to elicit bank MGRs' opinions about the evaluation of the need for training courses related to the implementation of AAOIFI's measurement standards. Descriptive statistics only were used to analyze the data, because there is a problem of measuring the significance of the test with a smaller number of observations concerning bank's MGRs' evaluation of cost of compliance.

Table 8.9 shows that all the MGRs perceive the need for training courses relating to the *Murabaha* and *Salam* standards as very high

Table 8.9: The evaluation of the need for training courses related to the standards

Bank's	The evaluation of training courses for measurement standards				
class	***Murabaha***	***Mudaraba***	***Musharaka***	***Salam***	**Equity of IAH**
Public banks	5	2	2	5	1
Private banks	5	2	2	5	1

Where 5= very high, 4= high, 3= moderate, 2= low and 1= very low

8.6 Discussion of the findings

The analysis carried out on the attitudes and opinions of the MGRs on the measurement standards has produced the following results.

1- More positive opinions were expressed on the implementation of the standards on *Mudaraba*, Equity of Investment Accounts, *Musharaka, Salam* and *Murabaha* (See Section 8.3 above). It follows that banks are more receptive to the implementation of the measurement standards than the disclosure standard. This might be attributed to the fact that there is a high cost of compliance (in terms of money, effort and training) associated with the implementation of the disclosure standard.

2- The findings of the case study appear to indicate that MGRs of private banks (with bonus plans) have more positive attitudes towards, and opinions on, the implementation of the standards than MGRs of public banks (with no bonus plans) [Section 8.4.1 above]. However, as discussed above, the bonus plan variable happens to be co-extensive with another independent variable (i.e. public/private). At the same time, MGRs of publicly owned banks appeared to have less positive attitudes towards, and opinions on, the implementation of AAOIFI's measurement standards (See section 8.4.1 above). The ownership (public/private) proposition is also related in the Sudanese context to the "political costs" hypothesis, because MGRs of publicly owned banks are more sensitive to political pressure (i.e., a profitable public bank might be ordered to invest in high risky national projects). The data thus support the ownership (public/ private) proposition.

3- As for the bank's size (value of total assets) variable, descriptive statistics indicate that MGRs of banks with a larger value of total assets have more negative attitudes towards, and opinions on, the implementation of the standards, as compared to those of banks with a smaller value of total assets. (See Section 8.4.2.above) The Chi square test also indicates that this difference is statistically significant. Thus, the findings provide support for the size hypothesis, namely the proposition that MGRs of banks with a larger value of total assets will have less positive attitudes towards, and opinions on, the implementation of the measurement standards than MGRs of banks with a smaller value of total assets. The size hypothesis is also related to the 'political cost hypothesis' and the result is consistent with findings from the studies of Watts and Zimmerman (1978) and Kelly (1982).

8.7 Summary and concluding remarks

It is noted that ownership (public/private) and bank size variables used as proxies for political costs are very important in explaining variation in banks MGRs' attitudes towards, and opinions on, the implementation of the standards. More precisely, the ownership variable (private/public) and bank size are used to explain differences in attitudes and opinions of MGRs of public and private banks. The variables are found to be statistically significantly associated with MGRs' opinions on implementation of the standards. This provides support for the ownership (public/ private) proposition (P4) and bank's size proposition (P5). This implies that public banks and banks with a larger value of total assets are more sensitive to political pressure (i.e. restrictions and/or obligations on those banks imposed by the government and regulators). The present study concludes that the opinions of preparers (Islamic banks) on the implementation of the standards are explained by similar (ownership and size) variables, to those in the USA. However, in this case bank MGRs', attitudes towards, and opinions on, the implementation of standards could not be explained by a bonus plan variable. This is probably due to the fact that in our selection of banks the bonus plan variable is found to be co-extensive with another independent variable, which in the Sudanese context is associated with political costs that may be faced by profitable public banks. This would give the latter an incentive to use profit–reducing accounting methods and hence resist new accounting measurement standards that restrict their ability to do this.

Finally, the expressed opinions of the respondents provide an indication of their attitudes towards the implementation of AAOIFI's measurement standards. However, those opinions could not be confirmed by the actual implementation of the standards in the selected (studied) banks. This is due to the fact that the researcher could not observe the implementation of the measurement standards.

Chapter 9

Evaluation of the Implications for Audit Risk Associated with the Implementation of the AAOIFI's Accounting Standards

9.1 Introduction and objective

In chapter 5 section 5.2.1 above, the following research question was developed:

How do bank EAs evaluate the implications for audit risk associated with the implementation of the accounting standards?

This question includes some other more specific itemized questions regarding the audit risk associated with *Shari'a* non-compliance risk (3 items) and with collectibility of receivables (3 items), {See Appendix 12 below}.

A single (embedded) case study approach, with cross-sectional comparisons between the sub-units of analysis, is used to test whether the theoretical propositions, derived from the normative research literature (e.g., the ARM and business risk in chapter 4 above) fit the data. The theoretical propositions are concerned with the attitudes and opinions of EAs on the implementation of AAOIFI's accounting standards (hereafter referred to as accounting standards). They include (1) *Shari'a* non-compliance[50] risk proposition (P6), and (2) collectability of receivable risk proposition (P7).

The main purpose of the present chapter therefore, is to analyze the findings of the case study relating to the opinions of EAs about the implications for audit risks associated with the implementation of the standards. The remainder of this chapter is organized as follows:

Section 2 presents similarities and differences in EAs' evaluation of audit risks associated with the implementation of the standards. Section 3 tests the two above propositions (P6 and P7). Section 4 discusses the main findings of the audit firms surveyed. Summary and concluding remarks are provided in section 5.

[50] An example of *Shari'a* non-compliance is a supposed *Murabaha to the Purchase Orderer* is in fact a straight loan with a charge for credit, with the asset never being acquired by the bank (the supposed seller). In other words, the bank's audited financial statements contained a material misstatement regarding earnings prohibited by Islamic *Shari'a* rules and principles. There is a risk that this would not be detected by the EA of such bank.

9.2 The main findings of the evaluation of *Shari'a* non- compliance risk

Question 2 in Section Ca concerns opinions of EAs on the implications for *Shari'a* non-compliance risk.

Question 2 in Section Ca: Items 1-3

1. Ignoring the existence of the internal control system, what is the probability that the implementation of AAOIFI's accounting standards would increase the risk of material misstatement of earnings prohibited by *Shari'a* in the bank's financial statements.
2. What is the likelihood that additional audit investment would be planned to ensure that, the bank's financial statements are prepared and presented in accordance with AAOIFIs' FAS 1 (presentation and disclosure).
3 What is the likelihood that additional audit fees would be charged for bank audit in accordance with AAOIFIs' FAS 1 (presentation and disclosure).

The questions in this section aimed to elicit the opinions of the EAs on the evaluation of the implications for audit risk associated with *Shari'a* non-compliance.

Table 9.1 shows that 15 usable responses were received from the respondents

Table 9.1: EAs' responses to *Shari'a* non compliance risk

Audit Firm	Client's class	Responses	Received	Usable Responses	Response Rate %
AG	Public	3	3	3	100
AD	Private	3	3	3	100
B&G	,,	3	3	3	100
M	,,	3	3	3	100
HAS	Foreign	3	3	3	100
	Total	15	15	15	100

The evaluation of implications for *Shari'a* non-compliance risk

Table 9.2 shows that the evaluation of the audit risk associated with *Shari'a non- compliance* is very high by the EAs of all the banks. Consequently, the assessment of the need for more audit evidence and fees is very high, except in the case of the EA of private banks, where it is high.

Table 9.2 The evaluation of implications for *Shari'a* non- compliance risk

Audit firm	Auditor of client's class	*Shari'a Non- Compliance* *Risk*	Evidence	Fees
AG	Public	5	5	5
B&G	Private	5	4	4
AD	,,	5	4	4
M	,,	5	4	4
Sub total		15	12	12
Average		5	4	4
HAS	Foreign	5	5	5

Where 5= very high, 4= high, 3= moderate, 2= low and 1= very low

9.3 The findings of the EAs' evaluation of collectibility of receivables risk

Question 2 in Section C.b concerns EAs' opinions on the evaluation of the implications for collectibility of receivables risk.

Question 2 in Section Cb: Items 1-3

1- Ignoring the existence of the internal control system, what is the probability that the implementation of *Murabaha* and *Salam* standards would increase the risk of material misstatement of the bank's assets (e.g. collectibility) in the bank's financial statements.
2. What is the likelihood that additional audit work would be planned to ensure that, the bank's balances and transactions are measured in accordance with AAOIFIs' measurement standards.
.3- What is the likelihood that additional audit fees would be charged for bank audit in accordance with AAOIFIs' measurement standards

Table 9.3 shows that 15 usable responses were received from the respondents

Table 9.3: EAs' responses to collectability of receivable risk according to bank's class

Audit firm	Clent's class	responses	Received	Usable Responses	Response Rate %
AG	Public	3	3	3	100
G&B	Private	3	3	3	100
AD	,,	3	3	3	100
M	,,	3	3	3	100
HAS	Foreign	3	3	3	100
	Total	15	15	15	100

The evaluation of audit risk associated with collectibility of receivables

Table 9.4 indicates that the evaluation of audit risk associated with collectibility of receivables (*Murabaha* and *Salam*) by the EAs is very high, except in the case of the EAs of private banks. The EA of public bank rates the need for more evidence as very high. However, the EAs of private banks rate the need for more evidence and more fees as low.

Table 9.4: The evaluation of implications for collectibility of receivables risk according to bank's class

Audit firm	Client's class	Collectibility of Receivables Risk	Evidence	Fees
AG	Public bank	5	5	3
B&G	Private bank	5	5	5
AD	"	5	1	1
M	"	1	1	1
Sub total		11	7	7
Average		3.7	2.3	2.3
HAS	Foreign bank	5	3	3

Where 5= very high, 4= high, 3= moderate, 2= low and 1= very low

9.4 Factors influencing EAs' evaluation of the implication for the audit risk

The effect of bank's proportion of *Murabaha* and *Salam* receivables on the EAs' evaluation of the implication for the audit risk is examined as follows:

9.4.1 The EAs' evaluation of the implication for *Shari'a* non-compliance risk

Descriptive Statistics

Table 9.5 indicates that the proposition of receivables to the value of total assets of a client bank makes no difference to the EAs' attitudes towards, and opinions on, the evaluation of the audit risk associated with S*haria's* non-compliance. The EAs of banks with a lower proportion of receivables (*Murabaha* and *Salam*) to the value of total assets evaluate the *Shari'a* non-compliance risk as the same high level as do the EAs of banks with a higher proportion of receivables. Therefore, there is no difference at all in EAs' attitudes towards, and opinions on, the evaluation of *Shari'a* non-compliance risk Thus, proposition 6 (P6 in Chapter 5 above) is not supported.

Table 9.5: EAs' evaluation of of the implication for *Shari'a* non- compliance according to bank's proportion of receivables[51]

Audit Firm	Bank's proportion of receivables to total assets	Rate		
		Shari'a non-compliance risk	Evidence	Fees
AG	Higher proportion	5	5	5
B&G	,, ,,	5	5 .	5
Sub total		10	10	10
Average		5	5	5
AD	Lower proportion	5	5	5
M	, ,,	5	2	2
HAS	, ,,	5	5	5
Sub total		15	12	12
Average		5	4	4

Where 5= very high, 4= high, 3= moderate, 2= low and 1= very low

[51] See Table 6.3 column 5.

9.4.2 EAs' evaluation of the implication for collectibility of receivables risk

a. Descriptive Statistics

Table 9.6 appears to show that the EAs of banks with a higher proportion of receivables, evaluate the implications for collectibility of receivables risk as greater than the EAs of banks with a lower proportion of receivables. Consequently, the evaluation of the need for more audit evidence by EAs of banks with higher proportion of receivables is very high and therefore, they would claim high fees.

Table 9.6: EAs' evaluation of of the implication for collectibility of receivables risk

Audit Firm	Bank's proportion of receivables to total assets	Rate: collectibility of receivables risk	Evidence	Fees
AG	Higher proportion	5	5	3
B&G	,, ,,	5	5	5
Sub total		10	10	10
Average		5	5	5
AD	Lower proportion	5	1	1
M	, ,,	1	1	1
HAS	, ,,	5	3	3
Sub total		11	5	5
Average		3.7	1.7	1.7

Where 5= very high, 4= high, 3= moderate, 2= low and 1= very low

b- Statistical test

A Kruskal Wallis test (X^2= 0.41 df=1) indicates that there is a statistically insignificant difference in EAs' attitudes towards, and opinions on, the evaluation of collectibility of receivables risk (See Table 9.7 below). The data suggest that there is a difference between the two categories of audit firms of the banks (See Table 9.6 above) and the difference is in the expected direction. However, according to Kruskal Wallis (KW) test this difference is not statistically significant. The lack of statistical significance may be due to sparseness of data i.e., small number of observations. Hence, P7 in chapter 5 above is not supported.

Table 9.7: Kruskal-Wallis tests

Independent variable	Dependent variables: EAs' evaluation of implications of collectability of risk	
	K-W Sig.	df
Murabaha and *Salam* receivables to the value of total assets	0.41	1

9.5 Discussion of the findings

The analysis carried out on the attitudes and opinions of the EAs on the evaluation of the implication of audit risk associated with the implementation of accounting standards has produced the following findings.

1. Descriptive statistics show (Section 9.3 above) that the evaluation of collectibility of receivables risk by the EA of public bank is very high, whereas the EAs of private banks rate such risk as high. The EA of public bank rates the need for more evidence as very high. However, the EAs of private banks rate the need for more evidence and more fees on average as low.

2. Descriptive statistics also show (section 9.4.1 above) that the evaluation of the risk associated with auditing of an Islamic bank according to *Shari'a* rules is high for all the audit firms surveyed. This means that there is no difference at all in EAs' opinions on, and attitudes towards, the evaluation of *Shari'a* non--compliance risk associated with the implementation of the disclosure standard. Hence, the results provide no support for proposition P6 (P6 in section 5.5 above). This implies that the level of receivables has no effect on EAs' opinions on the evaluation of the new type of audit risk (*Shari'a* compliance risk). The findings also indicate that four out of five audit firms perceive a high need for substantive testing (analytical review testing and transaction testing) in auditing an Islamic bank's financial statements according to *Sharia'* rules and principles. The key question is whether the EAs would change conventional audit procedures to accommodate *Shari'a* principles. It might be argued that almost all of the audit firms that were auditing Islamic banks, at the time of conducting this research, firmly adhered to conventional audit practice. For example, the auditors' reports (1998) on the audit of the selected banks did not give an opinion on whether the bank's activities comply with *Sharia'* rules and principles. This may be due to the fact that the surveyed audit firms have not yet developed an audit programme that copes with the new type of audit risk associated with *Shari'a* non-compliance. This necessitates the need for training courses (e.g., in-house training for EAs of Islamic banks).

3. Descriptive statistics indicate (see section 9.4.2) that the EAs of banks with a higher proportion of *Murabaha* and *Salam* receivables evaluate the implications for audit risk associated with collectibility of receivables as greater than the EAs of banks with a low proportion of receivables. Consequently, EAs of banks with higher proportion of receivables evaluate the need for more audit evidence as very high and therefore they would claim high fees. In contrast, EAs of banks with low proportion evaluate the need for more evidence and fees on average as low. The findings of the present study show that there is a difference between the average of evaluations of EAs banks with "higher" and "lower" proportion categories and the differences in the expected direction. According to KW test, the difference is statistically insignificant and thus there is no association between a bank's proportion of receivables (*Murabaha* and *Salam*) to the value of total assets and the EAs' evaluation of collectibility of receivables risk. Therefore, the results provide no support for proposition 7 in chapter 5 above. The results are inconsistent with Pratt and Stice's (1994) findings that EAs of firms with a higher proportion of receivables had evaluated the implications for audit risk associated with collectibility of receivables as high.

9.6 Summary and concluding remarks

The evaluation of the audit risk associated with *Shari'a* non-compliance is perceived as greater than for the other types of risk. This findings show that there is no difference at all in EAs' opinions on the implications for audit risk associated with *Shari'a* non-compliance. The finding provides no support for the *Shari'a* non-compliance risk proposition (P6) in chapter 5 above, indicating that EAs', attitudes towards and opinions about, the evaluation of such risk are not explained by the proportion of receivables (*Murabaha* and *Salam)* to total assets variable.

Evidence indicates that the collectibility risk proposition (P7) is not supported. The case study concludes that the independent variable (namely the proportion of receivables to total assets) that helps explain auditors' opinions in countries like USA does not have explanatory power in Sudan. The finding, however, is subject to the problem of sparseness of data in Sudan. The problem of sparse arise from the fact that there are only five audit firms in the present study i.e., small number of observations. Another reason might be that training and regulation are predominant in the USA professional bodies (e.g., AICPA), whereas the Sudanese professional bodies (e.g. SCCA) do not consider training and regulation in the context of auditing Islamic banks in Sudan. Moreover, US Statements of Auditing Standards, which were used to develop research propositions, are not applied in Sudan. The EA of public bank evaluates audit risk associated with collectibility of receivables as very high. This implies that *Murabaha* and *Salam* receivables are perceived as more risky to audit by the EA of public banks. This may be due to the fact that the staff working for the AG are less qualified than what is required or may be public banks have a problem of collectibility of *Salam* and *Murabaha* receivables.

Chapter 10

Summary, Conclusions and Suggestions

10.1 Introduction

The recent phenomenon of Islamic banking represents in some ways a radical departure from conventional banking practices. To comply with Islamic *Shari'a* rules and principles, an Islamic bank mobilizes funds on the system of profit sharing and uses those funds under Islamic modes of finance rather than interest-based modes. As an alternative to lending funds and charging interest thereon, Islamic banks use various modes of Islamic finance, including: *Musharaka* (profit-and-loss sharing mode), *Mudaraba* (equity), mark-up based modes (e.g., *Murabaha, Salam, Istisna*) and leasing modes (*Ijarah* and *Ijarah Muntahia Bittamleek*).

Each of the above Islamic modes of financing has some characteristics that resemble those of financial instruments used by conventional banks. However, Islamic modes of finance have specific Islamic Juristic rules that have no parallels in conventional financial instruments. Yet, IASs do not consider the specificity of Islamic financial instruments used by Islamic banks. Moreover, the items in financial statements of Islamic banks do not match in a number of cases to the items specified in the financial statements .of a conventional bank. This is because the financial statement items, which are mentioned in AAOIF's FAS 1, are largely the results of *Shari'a* compliant financial products and are interest-free and do not appear in the financial statements of conventional banks.

Attitudes of preparers of conventional financial statements have received considerable attention in the accounting research literature. This attention has largely been in Western countries. A major interest of the present study is that it examines the same issues in the setting of a less-developed market economy, namely that of Sudan. Another major interest is that the preparers in this case are the MGRs of Islamic banks. In addition, the new accounting standards deal with Islamic banks' transactions using *Shari'a* compliant financial instruments that are categorically different from those used by the conventional banks. The standards also have the support of the CBS as the regulator of the banking sector in Sudan. The sector operates according to the rules and principles of Islamic *Shari'a*. Therefore, the improvement of the transparency and comparability of financial reporting by means of appropriate accounting standards is intended to extend *Shari'a* compliance into the financial reporting process, and this is a new development. Moreover, the present study considers the opinions of EAs on new accounting standards, as an important topic on which there appears to be relatively little existing research literature.

In general, a number of theoretical propositions have been advanced in Western countries to explain and predict the attitudes and opinions of preparers of financial statements on the accounting standards. The present research study attempts to see how far these theoretical propositions can help explain the attitudes and opinions of MGRs of Islamic banks and their EAs in Sudan.

The remaining part of the present chapter is organised as follows:

Section 2 refers to the theoretical propositions, which are developed in chapter 5 above. Section 3 presents the use of a single (embedded) case study design. Section 4 summarises the main findings of the research study. Section 5 examines the limitations of the study and presents policy implications. Research opportunities and needs for further research are suggested in section 6.

10.2 The theoretical propositions

To date, the existing literature on the subject of Islamic accounting (in particular financial reporting) and auditing is very limited. Therefore, the research literature from which the research propositions (See chapter 3 and 4 above) were drawn was predominately that concerning conventional accounting and auditing, especially in the USA. According to the literature review, variables such as cost of compliance and listing status were particularly important in explaining variations in the attitudes of firms' MGRs towards disclosure requirements. Other variables including bonus plan and firm's size (value of total assets) were also used to explain difference in the attitudes of firms' MGRs towards the measurement standards. The present study also sheds light on variables that tend to explain differences in attitudes of the EAs towards the evaluation of implications for audit risk associated with collectability of receivables (e.g., credit risk), [See Chapter 4 above]. These variables include the proportion of receivables to total assets, sales growth and market value of equity. The study also examines EAs' evaluation of the audit risk associated with potential *Shari'a* non-compliance by their clients, where the clients are Islamic banks that have an obligation to comply with *Shari'a* rules and principles.

The present study also considered the major differences in the environments between the USA and Sudan such as the state of the economy, institutions, and culture. In terms of the economic environment, the USA is a highly developed market economy, which is based on a free market system, in which listed, unregulated, general trading companies play a predominant role. In contrast, Sudan's economy is still an emerging economy, in which a largely nationalized and regulated banking sector still plays a major role. As for cultural differences, the American culture is influenced and governed by secular laws. As an example, almost all disputes concerning litigation risk are solved in judicial courts. By contrast, Sudanese culture is influenced by religious and traditional considerations. Generally the disputes are solved outside courts. These differences might have implications for the findings of the present research study.

10.3 The design for case study

The main reasons for the selection of Sudan, as a single (embedded) case study, include:

1. Sudan represents a critical case in testing whether the theoretical propositions (frameworks) developed in Western countries can help explain the accounting phenomena in the context of a developing market economy (e.g., Sudan).
2. A research opportunity is provided by the introduction of a set of new accounting standards (AAOIFI's accounting standards) in a developing market economy like Sudan, where a substantial amount of state ownership exists.
3. The banking sector in Sudan operates to comply with Islamic *Shari'a* rules and principles
4. Using Sudan as a single (embedded) case study permits a more in-depth investigation when compared to using a survey including other countries that have adopted AAOIFI accounting standards (e.g., Bahrain and Jordan).
5. The number of Islamic banks and audit companies is limited therefore, the choice of sampling approach is problematic. A single (embedded) case study, with cross sectional comparisons of the sub-units of analysis, provided an alternative approach which offered

generalization to theoretical propositions rather than statistical generalization about the populations of Islamic banks and audit firms in Sudan.

A pilot case study was conducted on two Islamic banks in order to improve reliability of the questionnaire and to have an idea about the differences in opinions of MGRs of banks and their EAs about the implementation of the new AAOIFI accounting standards. The pilot case study approach was used with a combination of informal interviews and questionnaires to provide new insight on the study. The pilot case study suggested that the questionnaires concerning the opinions of GMRs and EAs needed to be redesigned.

Cross-sectional comparisons between banks indicated that the independent variables originally derived from the literature review were not sufficient to explain the variation in banks' opinions in Sudan. Other variables such as the cost of compliance were suggested to be included in explaining such differences. Independent variables were further identified according to banks' characteristics: namely, bank's size (number of branches); bank's size (value of total assets); listing status; bank's ownership (private /public); the existence of a bonus plan and proportion of receivables (*Murabaha* and *Salam*) to total assets. In this context, independent variables were identified to explain the difference in bank MGRs' opinions about the implementation of disclosure standard, namely cost of compliance (bank's number of branches) and listing status variables. With regard to the opinions of MGRs on the implementation of the measurement standards, a number of independent variables were identified. The independent variables include bank' (public/private) ownership, bank (value of total assets) size as proxies for political costs and the existence (non-existence) of a bonus plan. The proportion of receivables to total assets variable was used to try to explain the difference in EAs' opinions about the evaluation of implications for audit risk associated with the implementation of the new accounting standards.

Questionnaires, interviews and examination of documents were used as methods of data acquisition. Acquired data consist of opinions of the MGRs and EAs and their banks' actual compliance with AAOIFI's accounting standards. The opinions of the respondents provide an indication of their attitudes towards the implementation of the AAOIFI's accounting standards. Thus, "agree" or "disagree" as expressed in their opinions indicates positive or negative attitude towards the implementation of the standards.

10.4 The main findings

The overall percentage of responses received from all MGRs of banks included in the study indicates that banks' MGRs perceived the information needs of shareholders more clearly than of those others users of financial statements. This raises the issue of how to take into consideration the interests of others users of the bank's financial statements such as IAH.. Cross-sectional comparisons with the Chi-square contingency table indicate a significant difference in the attitudes and opinions of the MGRs of the banks with a larger number of branches and the MGRs of banks with a smaller number of branches. It follows that the findings provide support for the cost of compliance proposition 1 [(P1) in Chapter 5 above]. Moreover, the analysis shows significant variations in the opinions of listed banks and non-listed banks. Therefore, the case study findings support the listing status proposition 2 [(P2) in Chapter 5 above). In short, the findings indicate that the opinions on AAOIFI's standard were driven by similar variables as they are in the USA.

As for training issues, all the MGRs of banks included in the present study rate training costs as very high. Moreover, in discussions and meetings with the Deputy General MGR of *Alpha* Bank, he said: "our staff badly needs training for Islamic accounting standards, in particular the disclosure standard". It was also observed that the staffs working for *Alpha, Zubra* and *Asdar* have had less experience than what is required by the standard. This indicates a pressing need for training courses and workshops for the staff working for those banks. With regard to other costs of compliance in terms of money including audit fees and effort, almost all the MGRs of banks with a larger number of branches evaluate such costs as very high. Additionally, the MGRs thought that the preparation of their banks' financial statements, in accordance with the AAOIFI's FAS 1, would financially involve high costs. When asked about the cost implications of implementing the standard, the Deputy General MGRs of *Beta* and *Frasa* Banks expressed the views that "the cost would be high for the first two years of the implementation but no more than that". Furthermore, more positive attitudes and opinions were expressed on the implementation of the standards on *Mudaraba, Musharaka,* Equity of Investment Account Holders, *Murabaha* and *Salam* (See Section 8.3 above). It follows that the banks are more receptive to the implementation of the measurement standards than the disclosure standard. This might be attributed to the fact that there is a high cost of compliance (in terms of money, effort and training) associated with the implementation of the disclosure standard.

The difference in bank MGRs' attitudes towards, and opinions on, the implementation of measurement standards could not be explained by bonus plan variable, whereas the ownership [i.e. public/ private variable] proposition could. This is due to the fact that in our selection of banks the bonus plan variable is found to be co-extensive with another independent variable, which in the Sudanese context is associated with political costs that may be faced by profitable public banks. Once again, the analyses are conducted to show a significant variation in opinions and attitudes of MGRs of banks with a larger value of total assets and those of banks with a smaller value of total assets on the implementation of measurement standards. These findings provide support for the size proposition since MGRs of banks with a larger value of total assets have less positive attitudes towards, and opinions on, the implementation of measurement standards than those of banks with a smaller value of total assets. Accordingly, the case study suggests that both the ownership (public/private) variable and the size variable as proxies for political costs are very significant in explaining variations in banks MGRs' opinions on the implementation of the new measurement standards.

It can be concluded that the findings support the ownership proposition and the size proposition, but did not support the bonus plan proposition. These results suggest that political costs may be just as influential with regard to MGRs' attitudes towards, and opinions about, the measurement standards in Sudan as they are in Western countries (e.g., USA). This is an interesting result, given the political-economic differences between Sudan as a developing economy and advanced Western countries. It is observed that the MGRs' opinions about the implementation of the AAOIFI's disclosure standard are consistent with their actual compliance with the standard. Thus, the expressed opinions of the MGRs provide a reliable indicator of their attitudes towards the implementation of the standard. However, the opinions could not be confirmed by actual implementation of the measurement standards. Due to the fact that the researcher could not observe the implementation of these standards.

With regard to the evaluation of audit risk, cross-sectional comparisons using descriptive statistics show no difference the opinions of EAs on the evaluation of implications for *Shari'a* non-compliance risk. All EAs rated these risks as very high, irrespectively of whether their client bank had a larger or smaller proportion of receivables. The data suggest that there is no difference at all between the two categories of audit firms of the banks. With regard to collectibility of receivables risk there is a difference between the two categories of firms and the difference is in the expected direction. However, according to KW test this difference is not statistically significant. Hence the findings provide no significant support for the collectibility of receivables risk (P7 in chapter 5 above). In addition to, EAs of public banks evaluate the collectibility of receivables risk as very high.

In light of the above findings (a summary of chapter 7, 8 and 9), the following conclusions and suggestions are presented:

1. The senior MGRs of the selected banks cater to the perceived information needs of the shareholders more than for the needs of the other external users including IAHs. Nevertheless, in Sudan the present governance structure provided to the IAH by unrestricted *Mudaraba* contract looks quite thin (see Archer et al., 1998). This raises the issue of corporate governance, such as representation of stakeholders other than shareholders on boards of directors or audit committees of Islamic banks in Sudan.

2. The case study's findings indicate that the cost of compliance is a major problem for the implementation of AAOIFI's disclosure standard (FAS 1). Cost of compliance is highest for banks with a larger numbers of branches. These are the banks whose MGRs have the least positive attitudes towards, and opinions on the disclosure standard. Thus, the implementation of AAOIFI's FAS 1 has not gained general acceptance among banks with a larger numbers of branches.

3. Although Khartoum Stock Exchange (KSE) in Sudan is an emerging market, the banks' shares listed on KSE consist predominantly of those of privately-owned banks and the KSE's 2000 annual report illustrates this. Bank MGRs' attitudes towards, and opinions on, the implementation of the standard are largely influenced by cost-benefit consideration. In addition, it was also observed that bank MGRs' opinions about the implementation of the standard are consistent with their actual compliance with the standard. For instance, banks with a smaller number of branches have more positive opinions about, the implementation of the AAOIFI's standard, and simultaneously comply more with the standard than banks with a larger number of branches. Thus, the expressed opinions of

MGRs provide a reliable indicator of their attitudes towards the implementation of the standard. In short, banks' views on, and their actions to, the implementation of the standard are influenced by cost–benefit consideration. In other words enthusiastic banks perceive the potential benefits as greater than the potential costs; whereas non-enthusiastic banks perceive the cost of compliance as greater than potential benefits. Hence, cost and benefit considerations used by MGRs of Sudanase banks are similar to those used by the MGRs of US firms, regardless of the differences between the two economic and political enviroments.

4- The main purpose of Islamic bank's financial reporting is to provide information about financial position, performance and changes in the financial position that is useful to the main users (including IAH) in making economic decisions. The adoption of AAOIFI's accounting standards provides comparable financial statements. It also provides reliable and useful information, which can help investors like IAH to make wise decisions. AAOIFIs' accounting standards are major steps toward accounting harmonization and the comparability of financial statements issued by Islamic banks in Sudan. Comparable financial statements allow users to identify similarities and differences in banks' performance in relation to their own performance over time or in relation to other banks' performance. Yet, the case study's findings indicate significant differences in bank MGRs' attitudes towards, and opinions on, the implementation of the disclosure standard. This tends to lead to a diverse level of disclosure or limited disclosure by some banks and will result in non-comparable financial statements. The findings provide evidence for AAOIFI to work with other interested parties (e.g. the CBS and KSE) in order to have its present and future accounting standards fully implemented as mandatory requirements in Sudan.

5 The case study's findings also show differences in accounting policies and their level of disclosure. As consequence, the diverse accounting policies that are presently available for use can produce significantly different sets of financial statements based on the same events and conditions. This suggests that the CBS should work with Sudanese Council of Chartered Accountants (SCCA) and Sudanese Banks Union (SBU) to unify accounting systems and policies.

6- The CBS, as a regulatory body of banking sector, has directed all the banks (whether state-owned banks or privately-owned banks) to finance priority sectors (e.g., agriculture, industry, export). The CBS also sets a ceiling for each sector and commercial banks have to abide by the directives issued by the CBS. The government could ask the banks, in particular the state-owned banks to provide *Salam* facilities to agriculture, provided that the price of *al muslam fihi* (the subject matter of the goods) is predetermined by a joint committee between governmental units and the banks. Although, the state-owned banks are profit oriented they are supposed to finance national projects for socio-political reasons and this is relevant to the political costs theory. The case study's findings confirm that bank's (public/private) ownership and bank size (as a proxies for political costs) are the most important factors to explain differences in the attitudes and opinions of the MGEs on the implementation of AAOIFIs' measurement standards in Sudan. This confirms the view that public banks are more sensitive to political costs than private banks. Moreover, banks with larger value of total assets are more sensitive than banks with smaller value of total assets. This suggests that the opinions of bank MGRs on the measurement standards are largely, but not entirely, driven by similar variables in Sudan, as they are in the USA.

7- In general, the case study's findings demonstrate that the implementation of the measurement standards has gained more acceptances than that of the disclosure standard. This is because the implementation of the latter has been thought of as entailing high costs of compliance in terms of money, additional work and training courses for the staff working for these banks

8- Islamic banks are not allowed to accept and use funds on the basis of interest. Therefore, the financial statements of Islamic banks should be audited in order to attest that they are free from material misstatements (intentional or unintentional) regarding earnings prohibited by *Shari'a* (e.g., earnings from *Haram* (non-permitted) transactions). This represents a new type of audit risk related to non-compliance with *Shari'a*, since there is a risk of *Shari'a* non-compliance being the subject of undetected or unreported misstatements by management. However, in the present study the *Shari'a* non-compliance risk proposition , namely that perceived non-compliance risk is related to the proportion of Islamic modes of finance (*Salam* and *Murabaha* receivables) in the balance sheet, is not supported. This suggests that the opinions on the implications for the audit risk associated with the accounting standards are not explained by similar variable (proportion of receivables to total assets) as they are in the USA. Of course, in the USA the issue is related to the risk of misstatement of the receivables due to unrecognized collectibility problems, not problems due to failure to comply with requirements of *Shari'a* rules and principles.

9- In principle, a similar audit risk exists in Sudan, Islamic banks are exposed to a risk of misstatement of receivables. This may entail a risk of misstatement on the part of management related to the problem of unrecognized collectibility of receivables. EAs may fail to detect such misstatement. The findings of the present study show that there is a difference between the average of evaluations of EAs banks with "higher" and "lower" proportion categories and the difference is in the expected direction. The difference is found to be statistically insignificant and thus there is no significant association between a bank's proportion of receivables to the value of total assets and the EAs' evaluation of collectibility of receivables risk. The lack of significancy may be due to sparseness of data. The problem of sparse data arises from the fact that there are only five audit firms (small number of observations) in the present study. Another reason might be that training and regulation are predominant in the US professional bodies (e.g., AICPA), while the Sudanese professional bodies (e.g., SCCA) do not consider training and regulation in the context of auditing Islamic banks in Sudan. Moreover, US Statement of Auditing Standards , which were used to develop research propositions, are not applied in Sudan.

10- The EA of the public bank evaluates audit risk associated with collectibility of receivables as very high. This indicates that *Salam* and *Murabaha* are perceived as more risky to audit by the EA of public banks. This might be due to the fact that the staff working for the AG are less qualified than what is required or may be public banks have a particular problem of collectibility of *Salam* and *Murabaha* receivables

10.5 Limitations and policy implications of the study

There are some limitations in the present research study, which include:
(a) Social desirability bias. This is defined as 'The tendency for respondents to give answer to survey questions that are consistent with what society believes is right, proper, correct, or acceptable, creating bias in the results whenever the true answers are suppressed to meet social norms', (Alreck and Settle, (1995, p., 455). For the present study there is possibility of social desirability bias, since the implementation of AAOIFI's accounting standards in Sudan is backed by the CBS as supervisor of the banking sector, and this may introduce a bias into opinions expressed by respondents to the research questions. Social desirability bias may be reduced but not be completely removed. To minimize the social desirability bias in the present study, the researcher has made a clear statement within the covering letter of the questionnaire, to the respondents ensuring them of confidentiality and anonymity.

(b) The research study focused on using a single (embedded) case study (Sudan), with sub-units of analysis (Islamic banks and audit firms). The number of Islamic banks and audit firms was limited, making the use of sampling problematic. The alternative approach [single (embedded) case study design] offered generalization to some theoretical propositions relating to new accounting standards rather than empirical generalization about the population of Islamic banks and audit firms in Islamic countries (e.g., Bahrain, Pakistan and Iran).

Despite the limitations in this study, the results have some policy implications for AAOIFI and Sudanese regulators. The AAOIFI, CBS and KSE may find it useful to assess the implementation of the new set of accounting regulations issued by AAOIFI with respect to disclosure requirements and measurement standards that discussed in this research study. The findings provide evidence for AAOIFI to work with other interested parties (e.g. the CBS and KSE) in order to have its present and future accounting standards fully implemented as mandatory requirements in Sudan. It is in the interest of the CBS to pursue policies that promote comparability, relevance and reliability of the financial information disclosed by banks. Moreover, AAOIFI's accounting standards will improve the regulatory system established to supervise Islamic banking sector. For example, the CBS can issue a separate prudential regulations based on AAOIFI's accounting standards to supervise banks.

Furthermore, AAOIFI.s accounting standards help the CBS to promote strong measures for provisions, reserves, liquidity, and capital adequacy and risk management. The results also have implications for professional bodies in Sudan. The Sudanese Council of Chartered Accountants (SCCA) and Sudanese Accountants Society (SAS) may find it useful to assess those implications for audit risk associated with the implementation of the standards. These implications should be considered in decisions about formulating new training and audit programmes. The researcher believes that the general findings in this study if confirmed by other studies have important implications for setting of financial accounting standards for Islamic banks.

10.6 The need for further research

The conclusions drawn from the research study and limitations thereon suggest opportunities for future research, as follows:

1- The MGRs of Islamic banks' financial statements cater for the perceived information needs of shareholders more than those of IAH. This necessitates the need for future research on additional governance structures to protect the interests of IAH. For example, IAH could be represented in the board of directors or audit committee of an Islamic bank.

2- Limitations in retesting the bonus plan proposition in Sudan suggest the need for further research in other similar countries (e.g., Bahrain and Jordan).

3- Wider survey is needed in other similar countries (e.g. Pakistan and Iran) to overcome the problem of sparse data in the present study. Moreover, other explanatory variables (e.g. bank's number of branches) are suggested for further research to explain auditors' reaction to the audit risk associated with the implementation of AAOIFI's accounting standards.

4- *Murabaha* and *Salam* receivables are perceived as high risky areas to audit by EAs of public banks. This may be due to a human resource problem (unqualified audit staff), or may be a collectibility problem? Therefore, more in-depth investigation is needed to clarify this point in order to provide some possible guidance for its future solution.

Appendices

Appendix 1: Binding and Non-binding promise

In case of a binding promise, the following rules are followed:

a. If the purchaser (the bank) accepts the request of the orderer, it should purchase the asset and conclude a valid sale contract between itself and the vendor (the supplier) of the assets.

b. The purchaser offers the asset to the orderer (client), who should then accept it by legally binding mutual promise, and should accordingly establish a sale contract.

c. In this type of sale it is permissible to pay "*Hamish Gedyyah*[52]" when signing the original contract but only before the purchaser actually purchases the asset.

d. The purchaser may have recourse to *Haish Ggedyyah* in case of damages when the orderer declines to purchase the asset. If the *Hamish Gedyyah* falls short of the amount of damages, the bank may have recourse to the orderer for the remaining amount of the loss.

As for Non-binding promise, the following rules are followed.

a. One of the parties (i.e., the client) asks the other party (i.e., bank) to purchase an asset and promises that when the latter purchases the asset, the client will purchase it at a price that includes a mark-up profit thereon. The request made by the client is [53]considered as an indication of willingness to buy, not an offer to do so.

b. If the bank accepts this request it would proceed to purchase the asset under a valid sale contract concludes between itself and the supplier of the asset.

c. The bank should, after taking legal possession of the asset, offer it to the client according to the conditions of the first mutual promise. This is considered as an offer from the purchaser.

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[52] *Hamish gedayyah* is defined as the amount paid by the purchase orderer upon the request of the bank to make sure that the orderer is serious in his demand for the asset.

d. When the asset is offered to the client, he will have the option either to conclude a sale contract or decline to do so i.e., the orderer is not obliged to fulfil his promise. However, he chooses enter into a sale contract, it will be considered as an acceptance of the offer. A valid sale contract is thereby made between the client and the bank.

e. If it is made a requirement that the client should pay a first instalment, payment should be made after the contract is signed, and the instalment shall be regarded as part of the price in such a sale.

f. In the event that the client declines to purchase the asset, it will remain in the possession of the bank, who shall be entitled to dispose of it by any permissible means. However, the bank_would not enter in a *Murabaha* contract with a non-binding promise from the client, if the goods ordered could not be easily sold at a similar price to another customer.

In practice, specialized or thinly traded goods would not be ordered against a non-binding promise, since such goods cannot be easily sold at a similar price to another customer. Therefore, *Murabaha* with non-binding promise would be used only where there was a ready market for the goods being purchased.

Appendix 2: Comparison of International Accounting Standard (IAS 30 and other IASs) to Financial Accounting Standard (FAS 1)

IAS	FASI	Remarks
IAS 30 applies to all banks and similar financial institutions. The standard applies to both the separate and consolidated financial statements (pars 1-5).	FASI (The standard) applies to all Islamic banks, if the requirements of the standard contradict the bank's charter or the laws and regulation of the country in which it operates, a disclosure should be made of the contradiction.(par 1).	IAS 30 is not applicable to Islamic banks since their statutes prohibit them to receive or charge interests.
Accounting policies		
IAS 1 requires disclosure of a significant accounting policy should be made. Accounting method used for consolidation should be disclosed.	The standard requires disclosure of: accounting policies, which represent a choice among acceptable accounting methods and accounting policies for consolidation of the financial statements of subsidiaries (pars 11-13).	
Income statement		
The disclosure in the income statement Should include but not limited to, the following items of income and expenses.	The standard requires disclosure of:	
Interest and similar income	➢ Investment revenues, expenses and gains and losses by type.	
Interest charges and similar charge.	➢ Nature of material revenue expenses and gains.	
Dividend income.	➢ Losses from other activities.	
Fees and commission income.	➢ Estimated gains and losses from the revaluation of assets and liabilities	
Gains less losses arising from dealing securities.	➢ investment revenues, expenses, and gains and losses.	
Gains less losses arising from investment securities.	➢ Revenues and gains from unrestricted investments. ➢ Income and losses from investments	
Gains and losses arising from dealing in foreign currencies.	Share of unrestricted IAH in income (loss) from investment before the bank's share as *Mudarib*.	

Other operating income.	The Islamic bank's share in income (loss) from investment.	
Losses on loans and advances.	The Islamic bank's share (as *Mudarib*) in income from unrestricted investment accounts.	
General administrative expenses.	General and administrative expenses.	
Other operating expenses.	Other operating expenses.	
Income and expense items should not be offset except for those relating to hedges.	NA	
Gains and losses arising from each of the following :	NA	
Disposals and charges the amount of dealings securities (net).	"	
Disposals of investment securities (net)	"	
Dealing in foreign currencies (net)	The standard require similar disclosure	
Net income (loss)	Net income (loss) before Zakah and taxes	
Statement of financial position		
In addition to the requirements of other IAS, IAS 30 requires disclosure of the following:	The standard requires disclosure of:	
assets (pars 18-21)	assets (FAS 1, par 37)	
Cash and balances with the central bank.	Cash and cash equivalent	
Treasury bills and other bills eligible for rediscounting bills with the central bank.	NA	Islamic bank does not deal with interest based treasury bills and interest based government securities since Islam prohibits interest, alternatively Islamic bank can invest in Islamic *Mudaraba* Certificate (CMC).
Government and other securities held for dealing purposes.	"	
Placements with, and loans and advances to other banks	Receivables including *Murabaha,*and *Salam*	Islamic banks does not specifically deal with interest based–loans and advances
Other money market placements.	*Istisna*	
Loans and advances to customers.	*Musharaka*	
Investment securities.	*Mudaraba* investment	
IAS 2 (par 34 b) requires disclosure of total amounts of inventories .	Inventories (goods purchased for *Murabaha* sale)	

Assets acquired for leasing (IAS 17, par 43)	*Ijarah and Ijarah Muntahia Bittamleek*	
Tangible assets (IAS 5, par 12)	Fixed assets.	
Other assets	Other assets	
Liabilities:		
Deposits from other banks.	FAS 1 (par 41) requires disclosure of deposits from other bank	
Other money market deposits.	NA	
Amounts owed to other depositors.	Current accounts and saving accounts.	
Certificates of deposits..	Investment accounts with separate disclosure of unrestricted investment accounts	
Promissory notes and other liabilities.	*Salam* payable	Promissory notes and other liabilities
Other borrowed funds.	*Istisna*	Bearing interest are not used by Islamic banks, instead they use Islamic financial instruments.
Declared but undistributed profits (IAS 5)	The standard requires similar disclosure	
Tax payable.	*Zakah* and Tax payable.	Islamic banks are required to pay *Zakah*
Other account payable.	The standard requires similar disclosure	
NA	Unrestricted investment accounts should be disclosed and presented separately between liabilities and owners' equity.	Conventional bank dose not specifically deal with unrestricted investment accounts.
A consolidated balance sheet discloses minority interests (IAS 27).	FAS 1 require similar disclosure. The minority interest should be shown between unrestricted investment accounts and Owner's equity.	
The amount at which any asset and liability should not be offset by the deduction of another asset or liability, unless a legal right of set-off exists. (IAS 30, par 23).	FAS 1 (par 32) does not permit such offset unless there is a religious and legal right of set-off..	
The standard does not require current and non-current classification of assets and. Liabilities.	FAS 1, par. 36 also does not require such. Classification.	

Owners' equity		
Authorized, subscribed and paid–in capital.	The standard requires similar disclosure	
Number of authorized shares, number of issued shares, outstanding shares, par value per share and premium on issued shares.	‘’ ‘’ ‘’ ‘’	
Legal and discretionary reserves (IAS 5, par 17)	‘’ ‘’ ‘’ ‘’	
Retained earnings (IAS 5)	Retained earnings at the beginning and end of the period and amount of retained earnings resulting from the revaluation of assets and liabilities to their cash equivalent value where applicable (FAS 1, par 44).	
Cash flow statement		
IAS 7 requires the following disclosure: Differentiation between cash flows from operation, investing activities and financing activities.	Similar disclosure is required (FAS 1, par. 54-57).	
Net increase (decrease) in cash at the beginning and end of the period.	Similar disclosure is required.	
General disclosure		
Contingencies and commitments including off balance sheet items (IAS 10).	The standard requires similar disclosure.	
Maturates of assets and liabilities (IAS 30)	‘’ ‘’ ‘’ ‘’	
Concentration of assets and liabilities and off balance sheet items (IAS 30 and IAS 14).	‘’ ‘’ ‘’ ‘’	
Foreign currency exposures (the risk of losses arising from changing exchange rate (IAS 30, pars 40-42).	‘’ ‘’ ‘’ ‘’	
Losses on loan and advances (IAS 30, pars 43-46)	NA	Islamic bank does not deal with loans and advances.
General banking risks should be separately in retained earnings statement profit not as charges to and loss (IAS 30, pars 50).	NA	Islamic bank does not specifically require such disclosure, but as disclosure requirement, FAS 3 FAS 4 require a disclosure of a provision for loss.

Assets pledged as security (IAS 30, pars 53-54).	FAS 1 requires similar disclosure (par 25).	
Significant subsequent events to the date of the balance sheet (IAS 30 and IAS 10, pars 25-30).	Similar disclosure is required by the standard . (FAS 1, par 24).	
Related party transactions; nature of related party transaction, the types of the transactions and the elements of the transactions (IAS 30, pars 56-58 and IAS 24)..	FAS 1 requires similar disclosure (pars 28-29).	

Additional disclosures required only by AAOIFI's FAS 1

Islamic banks are required to prepare specific financial statements necessitated by their different nature and objectives, namely:

1. Statement of changes in restricted investment accounts (FAS 1, pars 61-64)
2. Statement of sources and uses of funds in *Zakah* and charity fund (FAS 1, pars 65-68)
3. Statement of sources and uses of *Quard* fund (FAS 1, paras, 69-73).

A further distinguishing feature of FAS 1 is the mount and extent of The following disclosure

1 Unusual supervisory restrictions imposed by central bank (FAS 1, par 14)

2 Amount and nature of prohibited earnings and expenditures by Islamic Shari'a. (FAS 1, par 15).

3 Concentration of unrestricted investment accounts (FAS1, par 17)

4 Distribution of unrestricted investment accounts, by type in accordance with their respective to maturity (FAS , par 18).

5 Any amount Islamic bank is obliged to deposit with other as compensation (FAS1, 20).

6 Number of *Shari'a* Board Members and the power and responsibility of the board.

7 Rules and regulations governing the *Zakah* payable by the bank, the calculation of the *Zakah* base for the year.

8 Share of unrestricted investment accounts and of the bank in the income or loss for the year. The policy applied for in the calculation of the share.

Appendix 3: Definitions

Audit risk (AR) is the risk that the assertion contains a misstatement exceeding tolerable error at the end of the audit.

Occurrence Risk (OR) is the risk that the assertion contains a misstatement prior to the audit.

Inherent risk (IR) is defined as: 'the susceptibility of an account balance or class of transactions to material misstatements, irrespective of related internal control' (Scannel, (op. cit., p., 42). In other words, the auditee's assertion contains a material misstatement that can not be related to the client's internal control system. Material misstatements may occur due to the client's environment or the nature of the item in the absence of controls (internal control system).

Inherent risk is considered at two levels:

Entity level; Auditors will have to consider certain attributes of the companies that are going to be audited. Moreover, auditors need to consider factors both outside and within the control of the company.

Factors outside the control of the company include: the economic and industrial environment in which the company operates, as well as the legislation, regulation and accounting practices affecting the industry.

Factors occurring within the control of the company include the nature of the company's business and its products, the size and numbers of locations of the company and the experience and integrity of the management and personnel.

Account level; Auditors will also have to consider the risk factors such as complexity involved in accounting for an item in the financial statements, e.g., balances or transactions subject to judgement (provisions, accruals) that can be overstated or understated in the company's financial statements (Ibid.p.43).

Control risk

Control risk (CR) is defined as: 'the risk that controls fail to prevent or detect misstatement' (Waller, 1993, p., 785). In other words, there is a possibility that a material misstatement would not be detected or prevented by internal control systems.

Control risk is considered at two levels:

General level; Auditors need to consider the environment in which the company operates, the structure of the company, and the existence of internal audit. Moreover, auditors will have to take into consideration control procedures set up (inter-alia) to prevent and detect errors and material misstatements in the financial records, (e.g., bank reconciliation). Furthermore, the auditor will carry out an initial assessment of the company's accounting system and its internal control system. If the initial assessment indicates that the internal control is likely to be effective, the auditor may decide to review the operation of the internal control system (ICS) in details, in order to confirm the initial assessment. If the preliminary assessment indicates that the ICS is poorly designed, the auditor will not proceed to test the operation of the control system (Scannel, op. cit., 43).

Detection risk (DR) is defined as: "the risk that the auditor's substantive procedures (tests of details of transactions and balances or analytical procedures) do not detect a misstatement that exists in an account balance or a class of transactions" (Ibid. p., 43). In other words, detection risk is the probability that material misstatements will not be detected by substantive testing.

Detection risk is likely to occur at two levels, sampling risk and non- sampling risk. For sampling risk, the sample may not give a true representation of the whole population (e.g., account balances) from which it is drawn.

Non-sampling risk is the risk that could arise from the application of inappropriate procedures or misapplication of appropriate procedures by audit staff.

Presentation of ARM:

Audit Risk (AR) = Occurrence Risk (OR)* Detection Risk (DR) (Waller, 1993). Furthermore, OR is decomposed into Inherent Risk (IR) and Control Risk (CR).

DR = AR/(IR * CR)

Appendix 4: Questionnaire: Bank MGRs' opinions about the implementation of the disclosure standard

The Implementation of accounting standards for Islamic banks" a Case Study of Preparers' and Auditors' Opinions in Sudan

To: The General manager ....

Dear respondent,

Assalam Alaikcum wa Rahmat Allah,

I am a postgraduate research student at School of Management Studies for the Service Sector - The University of Surrey- UK-.Currently am undertaking Ph.D. Research project on "the implementation of accounting standards for Islamic banks in Sudan", under supervision of Professor S. Archer and Professor R. Karim.

As part of the research, please find herewith the enclosed questionnaire. It concerns issues related to "Preparers and Auditors Opinion on the Implementation of AAOIFIs Disclosure Standard". The questionnaire has been formulated so that it can be quickly and easily completed. You are only required to circle the appropriate number -from scale-which best describe your agreement or disagreement with each statement.

It is highly appreciated if you could complete and return this questionnaire within two weeks of the date of receipt. Finally, I assure that the information you provide will be treated as highly confidential.

Many thanks in advance for your co-operation.

Yours sincerely

Badreldin Gurashi Mustafa

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Definitions of the Terminology Used

The external users of financial statements include; shareholders (SH), current account holders (CAH), investment account holders (IAH), Khartoum Stock Exchange (KSE) and general public (GP).

Islamic bank's financial statements include; statement of financial position, income statement, cash flow statement, the statement of changes in owners' equity or the statement of retained earnings, statement of changes in restricted investment, statement of sources and uses of funds in the *Quard* fund.

List of abbreviations:-

AAOIFI: The Accounting and Auditing Organization for Islamic Financial Institutions.

FAS 1: Financial Accounting Standard No 1: General Presentation and Disclosure in the Financial statements of Islamic Banks and Financial Institutions.

SH: Shareholders.

IAH: Investment Account Holders.

CAH: Current Account Holders.

KSE: Khartoum Stock Exchange.

GP: General Public.

Questionnaire

Section A

Please tick (/) the appropriate answer

1-Are you familiar with AAOIFIs' FAS 1?

Yes ( ) No ( )

If yes, please answer the following questions.

Please circle a number from the scale to show how much you agree or disagree

2.1- How much do you agree or disagree with the bank's statement of financial position, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.2- How much do you agree or disagree with the bank's statement of income, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.3- How much do you agree or disagree with the Bank's cash flow statement, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.4- How much do you agree or disagree with the bank's statement of changes in owners' equity or a statement of retained earnings, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users.

The scale

Users of the bank's financial Statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.5- How much do you agree or disagree with the bank's statement of changes in restricted investment, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.6- How much do you agree or disagree with the bank's statement of sources and uses of fund in the Quard fund, in accordance with AAOIFIs' FAS 1, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.7- How much do you agree or disagree with significant accounting policies, in the bank's notes to its financial statements, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.8- How much do you agree or disagree with an unusual supervisory restrictions imposed on the bank's activities by the Central Bank of Sudan, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.9- How much do you agree or disagree with earnings (e.g. earnings from *Haram* transactions) and expenditures prohibited by *Shari'a,* if any, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.10- How much do you agree or disagree with the bank's concentration of assets risk[53], should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

[53] Disclosure is made in the bank's financial statements of the magnitude of assets invested, deposited or used in any of the following concentrations;
a) An economic sector (e.g. the agriculture sector, the service sector, the manufacturing sector, the real state sector, etc.)
b) A customer, including another bank or a financial institution without stating the customer's name
c) A domestic geographical area with unique economic characteristics
d) Foreign countries

2.11- How much do you agree or disagree with concentration of sources of unrestricted investment accounts, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.12- How much do you agree or disagree with the distribution of unrestricted investment account,in accordance with their respective periods to maturity, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.13- How much do you agree or disagree with any material amounts the bank is obliged to deposit with others as compensating balances, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.14- How much do you agree or disagree with the bank's risk, associated with assets and liabilities which are denominated in foreign currencies, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.15- How much do you agree or disagree with risks associated with the bank's contingencies (e.g. letter of credits and letter of guarantee) should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.16- How much do you agree or disagree with the nature and the amounts of the bank's outstanding financial commitments, as of the statement of financial position date, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.17- How much do you agree or disagree with the subsequent significant events, as of bank's statement of financial position date, should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.18- How much do you agree or disagree with the nature and the amount of the bank's assets which are restricted for a particular use or used as a collateral for its obligation should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.19- How much do you agree or disagree with the nature and effects of the bank's accounting policies changes should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.20- How much do you agree or disagree with the method that used by the bank to allocate investment profits or (losses) between unrestricted investment account holders and the bank's as *Mudarib* should be disclosed to the following users.

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

2.21- How much do you agree or disagree with the bank's related parties transactions[54] should be disclosed to the following users.

[54] Related parties mean; members of the board of directors, members of *Shari'a* supervisory board, the bank's external auditor, its general manager and his deputies. Any natural person or entity which directly or indirectly owns a percentage of the bank's voting ownership, units and relatives of natural person to the second degree, and any entity in which any person in the above either directly or indirectly owns the percentage refereed to subsidies and other affiliates of the bank, (AAOIFI 1993)

The scale

Users of the bank's financial statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SH	1	2	3	4	5
IAH	1	2	3	4	5
CAH	1	2	3	4	5
KSE	1	2	3	4	5
GP	1	2	3	4	5

Please circle a number from the scale below

3- What is the likelihood that the bank's financial statements, which are prepared, in accordance with AAOIFIs' FAS 1, would involve the following additional costs.

The scale

1 very low 2 3 4 5 very high

Creating additional cost in monetary terms	1	2	3	4	5
Increasing the work load of the concerned bank staff	1	2	3	4	5
Increase the need for more training and educational courses.	1	2	3	4	5

Section B1

Appendix 5: Islamic bank MGRs' opinions on the implementation of *Murabaha* standard

1.1 Are you familiar with *Murabaha* and *Murabaha* to Purchase Orderer (Standard No.2) ?
Please tick (/) the appropriate answer
Yes ( ) No ( )

- If your answer is yes, please answer the following questions:

2.1 How much do you agree or disagree with the following accounting treatments?
Please pick the best answer from the scale and jot it to the right side of each statement

The scale

Strongly disagree	Disagree	Neutral	Agree	Strongly agree
1	2	3	4	5

1 The assets possessed by the bank for the purpose of selling them on the basis of *Murabaha* or *Murabaha to the Purchase Orderer* shall be measured at the time of their acquisition on an historical cost basis. ....

2 Assets available for sale after acquisition on the basis of *Murabaha to the Purchase Orderer* who is obliged to fulfil his promise shall be measured at their historical cost. A decline in the assets value shall be reflected in the valuation of the assets at the end of each financial period. ....

3 If the bank finds that there is an indication of possible non-recovery of the costs of goods available for sale on the basis of *Murabaha* or *Murabaha to the Purchase Orderer* who is not obliged to fulfil his promise, the asset shall be measured at the cash equivalent (i.e.net realizable) value. This shall be achieved by creating a provision for decline in the asset value to reflect the difference between acquisition cost and the cash equivalent value. ....

4 If the bank obtains a discount on the asset available for sale on the basis of *Murabaha to the Purchase Orderer*, such discount shall not be considered as revenue for the bank. Instead, the cost of the relevant goods shall be reduced by the amount of the discount. ....

5 The discount may, however, be treated as revenue for the bank if this is decided by *Shria*' supervisory board of the bank. Such revenue shall be recognized in the income statement. ....

6 Short-term or long-term *Murabaha* receivables shall be recorded at the time of occurrence at their face value. *Murabaha* receivables are measured at the end of the financial period at their cash equivalent value (i.e., the amount of debt due from the customers at the end of the financial period less any provision for doubtful debts). ....

7 Profits from *Murabaha* or *Murabaha to the Purchase Orderer* are recognized at the time of contracting if the sale is for cash or on credit not exceeding the current financial period. ....

8 Profits of a credit sale, which will be paid for either by means of one payment due after the current financial period or by installments over several future financial periods, shall be recognized by proportionate allocation of profits over the period of the credit. Whereby each financial period shall carry its portion of profits irrespective of whether or not cash is received. ....

9 As and when the installments are received. This method shall be used based on a decision made by *Shari'a* supervisory board of the bank, or ,if it is required by, supervisory authority. ....

10 The amount paid as *hamish gedyyah* is considered an obligation on the bank and shall be treated as a liability unless the *Shari'a* supervisory board of the Islamic bank decides otherwise. ....

11 The amount of *hamish gedyyah* is returned in full even if the asset is sold to another client at a lower price than that agreed upon by the client who was the original purchase orderer. ....

12 In the case of binding promise, the amount of actual loss shall be deducted from *hamish gedyyah*, (i.e., the bank shall not carry any losses). ....

13 If *hamish gedyyah* or other guarantees are not adequate or not available, any resultant loss to the bank shall be recorded as an amount due from the client provided there is evidence of his failure to fulfill his promise. .....

Appendix 6: Islamic bank MGRs' opinions on *Mudaraba* financing standard
Section B2:

1.2 Are you familiar with Financial Accounting Standards No.3 "*Mudaraba* Financing '?.

Yes ( ) No ( )

If yes please answer the following questions.

2.2 How much do you agree or disagree with the following accounting treatments?
Please pick the best answer from the scale and jot it to the right side of each statement.

The scale

Strongly disagree	Disagree	Neutral	Agree	Strongly agree
1	2	3	4	5

1 The bank's share in *Musharaka* capital (cash or kind) should be recognized when it is paid to the partner or made available to him on account of the *Musharaka*. ....

2 The bank's share in *Musharaka* capital provided in cash should be measured by the amount paid or made available to the partner on the account of the *Musharaka*. ....

3 The bank's share in *Musharaka* capital provided in kind (trading assets) should be measured at the fair value of the assets (the value agreed between the partners) and if the valuation results in a difference between fair value and book value, such difference should be recognized as a profit or loss to the bank. ....
4 The bank's share in the constant *Musharaka* capital should be measured at the end of the financial period at historical cost. ....
5 The bank's share in the diminishing *Musharaka* should be measured at the end of the period at historical cost after deducting from the historical cost of any share transferred to the partner (such transfer being by means of a sale at fair value) the difference between historical cost and fair value should be recognized as profit or loss in the bank's income statement. ....
6 If the diminishing *Musharaka* is liquidated before complete transfer is made to the partner. The amount recovered in respect of the bank's share should be credited to the bank's *Musharaka* financing account and any resulting profit or loss, namely the difference between the book value and the recovered amount, should be recognized in the bank's income statement. ....
7 If the *Musharaka* is terminated or liquidated and the bank's due share of the *Musharaka* capital remains unpaid when a settlement of account is made, the bank's share should be recognized as receivable due from the partner.
8 Profits or losses in respect of bank's share in *Musharaka* financing transactions that commence and end during a financial period should be recognized in the bank's account at the time of liquidation. ....
9 In the case of a constant *Musharaka* that continues for more than one financial period, the bank's share of profits for any period, resulting from partial or final settlement between the bank and the partner, should be recognized in its accounts for that period to the extent that the profits are being distributed, the bank's share of loss for any period should be recognized in its accounts for that period to the extent that such losses are being deducted from its share of the *Musahraka* capital. ....
10 Item .9 should apply to a diminishing *Musharaka* which continues for more than one financial period, after taking into consideration the decline in the bank's share in *Musharaka* capital and its profits or losses.
11 If losses are incurred in *Musharaka* due to the partner's misconduct or negligence, the partner should bear the bank's share of such losses; such losses should be recognized as receivable due from the partner. ....
12 The bank's unpaid share of the proceeds should be recorded in a *Musharaka* receivable accounts. A provision should be made for these receivables if they are doubtful. ....
13 Disclosure should be made in the notes to the financial statements for a financial-reporting period if the bank has made during the period a provision for a loss of its capital in *Musharaka* financing transactions. ....

Appendix 7: Islamic bank MGRs' opinions to *Musharaka* financing standard
Section B3:

1.3 Are you familiar with financial accounting standards No. 4 "*Musharaka* Financing"?

Yes ( ) No ( )

If yes please answer the following questions:

2.3 How much do you agree or disagree with the following accounting treatments?
Please pick the best answer from the scale and jot it to the right side of each statement.

The scale

Strongly disagree	disagree	Neutral	Agree	Strongly agree
1	2	3	4	5

1 The bank's share in *Musharaka* capital (cash or kind) should be recognized when it is paid to the partner or made available to

him on account of the *Musharaka*. ....

2 The bank's share in *Musharaka* capital provided in cash should be measured by the amount paid or made available to the partner on the account of the *Musharaka*. ....

3 The bank's share in *Musharaka* capital provided in kind (trading assets) should be measured at the fair value of the assets (the value agreed between the partners) and if the valuation results in a difference between fair value and book value, such difference should be recognized as a profit or loss to the bank ....

4. The bank's share in the constant *Musharaka* capital should be measured at the end of the financial period at historical cost. ....

5. The bank's share in the diminishing *Musharaka* should be measured at the end of the period at historical cost after deducting from the historical cost of any share transferred to the partner (such transfer being by means of a sale at fair value) the difference between historical cost and fair value should be recognized as profit or loss in the bank's income statement. ....

6. If the diminishing *Musharaka* is liquidated before complete transfer is made to the partner. The amount recovered in respect of the bank's share should be credited to the bank's *Musharaka* financing account and any resulting profit or loss, namely the difference between the book value and the recovered amount, should be recognized in the bank's income statement. ....

7. If the *Musharaka* is terminated or liquidated and the bank's due share of the *Musharaka* capital remains unpaid when a settlement of account is made, the bank's share should be recognized as receivable due from the partner. ....

8 Profits or losses in respect of bank's share in *Musharaka* financing transactions that commence and end during a financial period should be recognized in the bank's account at the time of liquidation. ....

9 In the case of a constant *Musharaka* that continues for more than one financial period, the bank's share of profits for any period, resulting from partial or final settlement between the bank and the partner, should be recognized in its accounts for that period to the extent that the profits are being distributed, the bank's share of loss for any period should be recognized in its accounts for that period to the extent that such losses are being deducted from its share of the *Musahraka* capital. ......

10 Item .9 should apply to a diminishing *Musharaka* which continues for more than one financial period, after taking into consideration the decline in the bank's share in *Musharaka* capital and its profits or losses.

11 If losses are incurred in *Musharaka* due to the partner's misconduct or negligence, the partner should bear the bank's share of such losses; such losses should be recognized as receivable due from the partner. ....

12 The bank's unpaid share of the proceeds should be recorded in a *Musharaka* receivable accounts. A provision should be made for these receivables if they are doubtful. ....

13 Disclosure should be made in the notes to the financial statements for a financial-reporting period if the bank has made during the period a provision for a loss of its capital in *Musharaka* financing transactions. ....

Appendix 8: Islamic bank MGRs' opinions about the implementation of Equity of Investment Account Holders standard

Section B4:

1.4 Are you familiar with Financial Accounting Standards No. 6 "Equity of Investment Account Holders?"

Yes ( ) No ( )

If yes please answer the following questions

2.4 How much do you agree or disagree with the following accounting treatments?

Please pick the best answer from the scale and jot it to the right side of each statement:

The scale

Strongly disagree	disagree	Neutral	Agree	Strongly agree
1	2	3	4	5

1	Equity of unrestricted investment account holders should be measured by the amount received by the bank at the time of contracting. ....
2	At the end of financial period, equity of unrestricted investment account holders should be measured at their book value.....
3	Profits of an investment jointly financed by the bank and unrestricted investment accounts holders should be allocated between them according to the contribution of each of the two parties in the jointly financed investment. ....
4	Loss resulting from transactions in a jointly financed investment (that is recognized during a period other than that in which final settlement of the investment account is made) should in the first instance be deduced from any undistributed profits on the investment. ....
5.	Any such loss in excess of the amount of undistributed profits should be deducted from provisions for investment losses formed for this purpose. The remaining loss, if any, should be deduced from the respective equity shares in the joint investment of the bank and the unrestricted investment accounts holders, according to each party's contribution to the joint investment. ....
6	Loss due to misconduct or negligence on the part of the bank, based on the opinion of the *Shari'a* supervisory board of the bank, should be deducted from the bank's share in the profits of the jointly financed investment. In case the loss exceeds the bank's share of profits the difference should be deduced from its equity share in the joint investment, if any, or recognized as due from the bank. ....
7	Assets and liabilities relating to equity of restricted investment account holders and their equivalent should be treated separately from the bank's assets and liabilities. ....
8	Equity of restricted investment accounts holders should be measured by the amount received by the bank or the client's purchase price of the units or shares brought by him at the time of contracting. ....
9	At the end of financial period, equity of restricted investment account holders should be measured at its book value. ......
10	In the case the bank has funds invested in restricted investment accounts whether from its own equity or from other funds at its disposal, the bank should share in the profits earned on such funds in its capacity as provider of funds. ....

Appendix 9: questionnaire: Islamic bank MGRs' opinions on the implementation of *Salam* standard

Section B5:

1.5 Are you familiar with *Salam* and Parallel *Salam* Standard (FAS 7)

Yes ( ) No ( )

If yes please answer the following questions

2.5 How much do you agree or disagree with the following statements.

Please pick the best answer from the scale and jot it to the right side of each statement.

1	*Salam* financing shall be recognized when the capital of *Salam* is paid (whether in cash, kind or benefit) to al *muslam ileihi* or when it is made available to him. ....
2	Parallel *Salam* transactions shall be recognized when the bank receives the capital of *Salam* (in cash, kind or benefit). ....
3	The capital of *Salam* shall be measured by the amount paid at the time of contracting. ....

4	Capital of *Salam* provided in kind, or benefit shall be measured at the fair value (the value agreed between the bank and the client) of the asset or provided benefit. ....
5	The capital of *Salam* is measured at the end of a financial period as in item 4. However, if it is probable that *al-muslam ileihi* will not deliver *al-muslam fihi* in full or in part, or it is probable that the value of *al-muslam fihi* will decline, the bank shall make a provision of the amount of the estimated deficit. ....
6	Assets constitutive of *al-muslam fihi* received by the bank in accordance with contract are recorded at their historical cost. ....
7	If the market value (or the fair value if the market value is not available) of the received *al-muslam fihi* is equal to the value of contract *al muslam fihi*, the received *al-muslam fihi* shall be measured and recorded at book value. ....
8	If the market value of the received *al-muslam fihi* is lower than the book value of contracted *al-muslam fihi*, the received *al- musalm fihi* shall be measured and recorded at market value (or fair value) at the time of delivery and the difference shall be recognized as loss. ....
9	If the *Salam* financing contract is completely or partially cancelled and the client has failed to repay the capital of *Salam* or the required portion thereof, the amount due shall be recognized as receivable due from the client .. ..
10	In case the bank has securities pledged for *al-muslam fihi* and the profits from the sale of the securities are less than the book value, the different is recognized as a receivable due from the client. Alternatively, if the proceeds are less than the book value then the difference is credited to the client. ....
11	At the end of a financial period, assets acquired through *Salam* financing shall be measured at the lower of historical cost and cash equivalent value, and if the cash equivalent value is lower, the difference shall be recognized as loss in the income statement. ....
12	Upon delivery of *al muslam fihi* by the bank to the client in a parallel *Salam*, the difference between the amount paid by the client and the cost of *al-muslam fihi* shall be recognized as profit or loss. ....

Question 3

How do MGRs evaluate the need for training courses related to the implementation of the measurement standards?

The scale

1 very low 2 3 4 5 very high

Murabaha and Murabaha to Purchase Orderer

....

Mudaraba Financing

....

Musharaka Financing

....

Salam and Parallel Salam

....

Equity of Investment Account Holders

....

Appendix 10: Questionnaire: The assessment of implications for audit risk associated with the implementation of AAOIFI's accounting standards.

A Survey Study as a part of the case Study of the Implementation of accounting standards for Islamic banks: Preparers' and Auditors' Opinions in Sudan

To: The External Auditor of ....

Dear respondent,

Assalam Alaikcum Wa Rahmat Allah,

I am a post graduate researcher at school of Management studies for the Service Sector, - The university of Surrey - UK. Currently am undertaking Ph.D research project on the "Preparers and Auditors Opinions on the Implementation of AAOIFI's accounting standards in Sudan", under supervision of Professor S. Archer and Professor R. Karim.

As part of the research, please find herewith the enclosed questionnaire. It concerns issues related to the assessment of the implications for audit risk associated with the implementation of the new standards. The questionnaire has been formulated so that it can be quickly and easily completed. You are only required to circle the appropriate number-from scale-which best describe your opinion on each statement.

It is highly appreciated if you could complete and return this questionnaire within two weeks of the date of receipt. Finally, I assure that the information you provide will be treated as highly confidential.

Many thanks in advance for your co-operation

Yours sincerely,

Badreldin Gurashi Mustafa,
Foreign Exchange Dept.
Bank of Sudan, Khartoum

List of abbreviations used:-

AAOIFIs: Accounting and Auditing Organisation for Islamic Financial Institutions.
FAS 1: Financial Accounting Standard No 1: General Presentation and Disclosure in the Financial statements of Islamic Banks and Financial Institutions.

AAOIFI measurement standards include *Murabaha* and *Murabaha* to the purchase order and *Salam* and parallel *Salam.*

Inherent risk (IR): IR is the likelihood that the financial statements contain material misstatements, before considering the possible prevention or detection of such misstatements by the internal control system.

IR can be considered at two levels:

- Entity level and
- Account balance level

At entity level, the auditor needs to consider that there are certain characteristics of the bank or its environment that increase the likelihood that the financial statements contain material misstatements. For example, a bank operates in a highly competitive market, increasing the pressure on management for disclosing good results and disguise bad results. The pressure on the management increases and subsequently, the likelihood that the financial statements contain material misstatements increases.

Control risk (CR): CR is the likelihood that, if the financial statements contain material misstatements that would not be prevented or detected by the internal control system.

Questionnaire:

Section CA:

Please tick (√) the appropriate answer

.I- Are you familiar with AAOIFIs' FAS 1 (General presentation and disclosure standard) ?

Yes ( ) No ( )

If yes, please answer the following questions

Scenario 1: Irregularity: -

The auditor of the bank issued an unqualified audit report and then competent audit staff discovered that the bank's audited financial statements contained a material misstatement regarding earnings prohibited by Islamic *Shari'a* (i.e. earnings that are inconsistent with *Shari'a* rules and principles and AAOIFI accounting standards). Moreover, they verified that the accounting treatment of prohibited earnings was **intentional** and resulted from a **deliberate** miscommunication between the investment department and the *Shari'a* Supervisory Board (SSB). Subsequently, competent audit staff suspect that it is **highly likely** that management was **aware** that this treatment was inconsistent with Shari'a rules and principles and AAOIFI accounting standards and nevertheless supported it.

Based on the above **scenario** please answer the questions 2.1 – 2.3 by picking the appropriate number from the scale which best describes your answer and jot it in the space to the right of the item

Scale

1 very low 2 3 4 5 very high

2.1 Ignoring the existence of the internal control system, what is the probability that the implementation of AAOIFI's accounting standards would increase the risk of material misstatement of earnings prohibited by *Shari'a* in the bank's financial statement. ......

Scale

1 very low 2 3 4 5 very high

2.2 What is the likelihood that additional audit investment would be planned to ensure that, the bank's financial statements are prepared and presented in accordance with AAOIFIs' FAS 1 (presentation and disclosure). ....

2.3 - What is the likelihood that additional audit fees would be charged for bank audit in accordance with AAOIFIs' FAS 1 (presentation and disclosure). ....

Section C A

Please tick (√) the appropriate answer

I- Are you familiar with AAOIFIs' measurement standards (e.g. *Murabaha* and *Murabaha* to the purchase order, and *Salam* and Parallel *Salam*)?

Yes ( ) No ( )

If yes, please answer the following questions

Scenario 2:

The auditor of the bank issued an unqualified audit report and then competent audit staff discovered that the bank's audited financial statements contained a material misstatement regarding understatement of provision of doubtful debts of *Murabaha* receivable and/or that of estimated deficit of *al-Muslam fihi* (i.e. the understatement of provision that is inconsistent with AAOIFI accounting standards and international accounting standards). Moreover, they verified that the understatement of the provision was **intentional** and resulted from a **deliberate** miscommunication between the financial department and the internal audit department. Consequently, competent audit staffs suspect that it is **highly likely** that management was **aware** that this treatment was inconsistent with AAOIFI accounting standards and nevertheless supported it.

Based on the above **scenario** please answer the questions 3.1 – 3.3 by picking the appropriate number from the scale which best describes your answer and jot it in the space to the right of the item

Scale

1 very low	2	3	4	5 very high

3.1- Ignoring the existence of the internal control system, what is the probability that the implementation of *Murabaha* and *Salam* standards would increase the risk of material misstatement of the bank's assets (e.g. collectibility) in the bank's financial statements. ------

3.2- What is the likelihood that additional audit work would be planned to ensure that, the bank's balances and transactions are measured in accordance with AAOIFIs' measurement standards. ---------

3.3 - What is the likelihood that additional audit fees would be charged for bank audit in accordance with AAOIFIs' measurement standards. ----------

Please pick a number from the scale which best describes your answer and jot it in the space to the right of the item

Scale

1 very low 2 3 4 5 very high

4.1 - What is the likelihood that an audit of your client bank, in accordance with Islamic *Shari'a* principles and AAOIFIs' disclosure standard, would entail training and educational courses for the audit staff. ---------------

4.2 - What is the likelihood that an audit of your client bank, in accordance with AAOIFIs' measurement standards, would entail training and educational courses for the audit staff.----

If your answer of the above two statements was number 4 or 5, please specify a relevant training and educational courses that would be needed for the audit staff: ....

1- ....

2-..

3- ....

4-..

Appendix 11: Analysis of the pilot case study

1 Overall analysis

In general, table (a) shows that the MGR of Beta bank had a more positive attitude towards, and opinions on , the implementation of AAOIFI's disclosure standard (hereafter the disclosure standard) than the MGR of Alpha bank.

Table a: Bank MGR's opinions about the implementation of the disclosure standard

Banks	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Alpha	27%	26%	17%	21%	9%
Beta	80%	10%	9%	1%	-

2 Bank MGRs' opinions on conveying accounting information to the board of directors

Table (a2) indicates that MGRs of Alpha and Beta bank had agreed to convey almost all information, in accordance with the disclosure standard, to the perceived need of the board of directors. Therefore, there was insignificant difference in bank MGRs' attitudes towards, and opinions on, disclosing the information to the board of directors.

Table a2: bank MGRs' opinions on conveying information to the board of directors

Banks	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Alpha	83%	11%	6%	0%	0%
Beta	100%	-	-	-	-

3 Banks MGRr' opinions on conveying accounting information to shareholders

Table (a3) shows that MGR of Beta bank had more positive attitudes towards, and opinions on furnishing shareholders with information, in accordance with AAOIFI's FAS 1, than MGR of Alpha bank. Thus, there was a significant difference in banks' attitude towards, and opinions on, disclosing the information to the perceived need of shareholders.

Table a3: Bank MGRs' opinions on conveying information to shareholders

Banks	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Alpha	61%	11%	22%	6%	0%
Beta	94%	6%	0%	0%	0%

4 Bank MGRs' opinions on conveying accounting information to investment account holders (IAH)

Table (a4) indicates that MGR of Beta had more positive attitude towards, and opinions about, conveying accounting information, in accordance with the disclosure standard, to IAH than MGR of Alpha. It follows that, there was a significant difference in bank MGRs' attitude towards, and opinions on, disclosing the information to the perceived need of IAH.

Table a4: Bank MGRs' opinions on conveying information to investment account holders

Banks	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Alpha	11	22%	33%	33%	0%
Beta	94%	-	-	6%	0%

5 Banks MGRS' opinions on conveying accounting information to current account holders (CAH)

Table a5 shows that MGR of Beta had more positive attitude towards, and opinions about, conveying information, in accordance with the disclosure standard, to CAH than MGR of Alpha. Hence, there was a significant difference in bank MGRs' attitude towards, and opinions on, disclosing the information to the perceived need of CAH

Table a5: Bank MGRs' opinions on conveying information to current account holders

Banks	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Alpha	6%	28%	33%	33%	0%
Beta	50%	22%	22%	6%	0%

6. Bank MGRs' opinions on conveying accounting information *to the Central Bank* of Sudan

Table (a6) shows that MGRs of Alpha and Beta banks had agreed to conveying information, in accordance with the disclosure standard, to the perceived need of the Central Bank of Sudan. This implies that there was insignificant difference in bank MGRs' attitude towards, and opinions about, disclosing the information to the Central Bank of Sudan.

Table a6: Bank MGRs' opinions on conveying information to the Central Bank of Sudan

Banks	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Alpha	17%	78%	6%	-	-
Beta	100%	-	-	-	-

7 Bank MGRs opinions on conveying accounting information to KSE

Table (a7) indicates that the MGR of Beta had more positive attitude towards, and opinions about, conveying accounting information, in accordance with the disclosure standard, to KSE than the manager of Alpha Therefore, there was a significant difference in bank MGRs' attitude towards, and opinions on, disclosing the information to the perceived need of KSE.

Table a7: Bank MGRS' opinions on conveying information to the KSE

Banks	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Alpha	0%	17%	11%	56%	17%
Beta	83%	6%	11%	0%	0%

8. Bank MGRs' opinions on conveying accounting information to the general public

Table (a8) shows that MGR of Beta had more positive attitude towards, and opinions about, conveying accounting information, in accordance with the disclosure standard, to the general public than MGR of Alpha. It follows that, there was a significant difference in bank MGRs' opinions on disclosing the information to the perceived need of general public.

Table a8: Bank MGRs' opinions on conveying information to the general public

Banks	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Alpha	11%	17%	6%	22%	0%
Beta	39%	33%	28%	0%	0%

Overall, the pilot case study, with cross-sectional comparison, indicated that there was insignificant difference in bank MGRs' attitudes towards, opinions about, disclosing information, in accordance with AAOIFIs' FAS 1, to the Board of Directors and the CBS[55]. The findings from the pilot studies showed that there was a significant difference in opinions between the two banks in disclosing information, in accordance with AAOIFIs' FAS 1, to

[55] This is because Islamic banks are required to disclose all necessary information to the bank's Board of Directors and the CBS as regulatory body. Accordingly, the statements (items) relating to those users were omitted from the original questionnaire.

shareholders, investment account holders, Khartoum stock exchange and the general public. Thus, this necessitates the need to reformulate the questionnaire.

As for measurement standards, the finding from the pilot studies showed that there was a significant differences in bank MGRs' attitude towards, opinions on, the implementation of AAOIFIs' measurement standards[56]. The following table shows the bank MGRs' attitudes towards, and opinions on, the implementation of the measurement standards.

Banks	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Alpha	23%	61%	6%	10%	0%
Beta	83%	11%	6%	0%	0%

With regard to the assessment of audit risk by the external auditor, questions were asked to the Deputy Auditor General about the implications for audit risk associated with the implementation of AAOIFI's accounting standards. An external auditor from private audit firm was requested to test the questionnaire. Accordingly, the questionnaire was redesigned to include questions regarding the audit risk associated with *Shari'a* compliance.

[56] Measurement standards include *Murabaha* and *Murabaha* to purchase orderer, *Mudaraba* financing, *Musharaka* financing, *Salam* and Parallel *Salam* and Equity of Investment Accounts.

Appendix 12: Agenda

1- Whether the financial accounting disclosure, in accordance with AAOIFIs' FAS: 1, to the external users would infringe the bank's privacy ?.

2- Whether the financial accounting disclosure, in accordance with AAOIFIs' FAS: 1, to the external users would reduce the bank's capabilities to compete with similar banks or other banks such as conventional banks at regional or international levels?.

3- Whether the preparation and presentation of the bank's financial statements, in accordance with AAOIFIs' FAS: 1, would increase executive management's responsibilities?.

4- Whether the financial accounting disclosure, in accordance with AAOIFIs' FAS: 1, would expose the bank's executive management to additional accountability?

5- Whether the bank's compliance with AAOIFIs' FAS: 1, would support the autonomy of executive management?

6- Would you please specify additional financial costs incurred as a result of the implementation of AAOIFIs disclosure standard?

Appendix 13a: Question regarding disclosure requirements (FAS1)

Reliability analysis (Alpha)

Reliability coefficient 105 items

Alpha	= 0.9798

Reliability analysis (Spilt-half)

Reliability coefficient 105 items

Correlation between forms	= 0.8026	Equal-length Spearman-Brown	= 0.8905
Guttman Split-half	= 0.8835	Unegual-length Spearman-Brown	= 0.8905
Alpha for part 1	= 0.9657	Alpha for part 2	= 0.9651
53 items in part 1		52 items in part 2	

Appendix 13 b: Question concerning cost implications for disclosure standard

Reliability analysis (Alpha)

Reliability coefficient 3 items

Alpha	= 0.9400

Reliability analysis (Spilt-half)

Reliability coefficient 3 items

Correlation between forms	= 0.8122	Equal-length Spearman-Brown	= 0.8963
Guttman Split-half	= 0.7733	Unegual-length Spearman-Brown	= 0.9095
Alpha for part 1	= 0.9600	Alpha for part 2	= 1.0000
2 items in part 1		1 item in part 2	

Appendix 13c: Question regarding measurement standards

Reliability analysis (Alpha)			
Reliability coefficient 62 items			
Alpha	= 0.9454		
Reliability analysis (Spilt-half)			
Reliability coefficient 62 items			
Correlation between forms	= 0.7422	Equal-length Spearman-Brown	= 0.8520
Guttman Split-half	= 0.8501	Unegual-length Spearman-Brown	= 0.8520
Alpha for part 1	= 0.9406	Alpha for part 2	= 0.8687
31 items in part 1		31 items in part 2	

Appendix 14: MGRs' opinions and the computation of Chi-square test concerning the bank's size

Responses/ type of bank	Banks with larger Numbers of branches		Banks with smaller numbers of branches		
	Fo	Fe	Fo	Fe	Total
Positive	140	195.43	316	260.57	426
Neutral	110	65.14	42	86.86	152
Negative	65	54.43	62	72.57	127
Total	315		420		735

Fo	**Fe**	**(Fo - Fe)**	**(Fo - Fe)^2**	**(Fo - Fe)^2/Fe**
140	195,43	-55.43	3o72.48	15.72
110	65.41	+44.86	2.012.42	30.89
65	54.43	+10.57	111.72	2.05
316	260.57	+55.43	3.072.48	11.79
42	86.86	-44.86	2.012.42	23.17
62	72.57	-10.57	111.72	1.54
X^2				85.16

Appendix 15: Computation of Chi-square test regarding the listing status proposition

Responses/ type of bank	Listed banks		Non-listed banks		
	Fo	Fe	Fo	Fe	Total
Positive	247	226.29	149	169.71	396
Neutral	70	68.57	50	51.43	120
Negative	19	41.41	53	30.86	72
Total	336		252		588

Fo	**Fe**	**(Fo - Fe)**	**(Fo - Fe)^2**	**(Fo - Fe)^2/Fe**
247	226.29	+20.71	428.90	1.89
70	68.57	+1.43	2..04	0.03
19	41.41	-22.14	490.18	11.91
149	169.71	-20.71	428.9	2.53
50	51.43	-1.43	2.04	0.04
53	30.86	+22.14	490.18	15.88
X^2				32.28

Appendix 16: Banks' actual implementation of the standard and the computation of Chi-square test according to bank's size

Actual implementation/ bank size	Banks with larger Numbers of branches		Banks with smaller numbers of branches		
	Fo	Fe	Fo	Fe	Total
Fully implemented	3	6.43	12	8.57	15
Partially implemented	7	4.71	4	6.29	11
Not implemented	5	3.86	4	5.14	9
Total	15		20		35

Fo	**Fe**	**(Fo - Fe)**	**(Fo - Fe)^2**	**(Fo - Fe)^2/Fe**
3	6,43	-3..43	11.76	1.83
7	4.71	+2.20	5.24	1.11
5	3.86	+1.14	1.29	0.34
12	8.57	+3.43	11.76	1.37
4	6.29	-2.29	5.24	0.83
4	5.14	-1.14	1.29	0.25
X^2				5.73

Appendix 17: Banks' actual implementation of the standard and the computation of Chi-square test according to bank's listing status

Actual implementation/ bank's listing status	Listed banks		Non-listed		
	Fo	Fe	Fo	Fe	Total
Fully implemented	13	8.57	2	6.43	15
Partially implemented	4	6.29	7	4.71	11
Not implemented	3	5.14	6	3.86	9
Total	20		15		35

Fo	**Fe**	**(Fo - Fe)**	**(Fo - Fe)^2**	**(Fo - Fe)^2/Fe**
13	8,57	4..43	19.62	2.29
4	6.29	-2.29	5.24	0.83
3	5.14	-2.14	4.58	0.89
2	6.43	-4.43	19.62	3.05
7	4.71	2.29	5.24	1.11
6	3.86	2.14	4.58	1.19
X^2				9.36

Appendix 18: Computation of Chi-square test according to ownership (bonus plan) proposition

Responses/ type of bank	Private banks (with bonus plan)		Public banks (with no-bonus plan)		
	Fo	Fe	Fo	Fe	Total
Positive	174	158.73	124	139.27	298
Neutral	29	27.17	22	23.83	51
Negative	9	26.10	40	22.90	49
Total	212		186		398

Fo	**Fe**	**(Fo - Fe)**	**(Fo - Fe)^2**	**(Fo - Fe)^2/Fe**
174	158.73	+15.27	233.17	1.47
29	27.17	+1.83	3.35	0.12
9	26.10	-17.10	292.41	10.76
124	139.27	-15.27	233.17	1.67
22	23.83	-1.83	3.35	0.15
40	22.90	+17.10	292.41	2.77
X^				26.94

Appendix 19: Computation of Chi-square test according to the bank size (value of total assets) proposition

Responses/ type of bank	Banks with large value of total assets		Banks with small value of total assets		
	Fo	Fe	Fo	Fe	Total
Positive	108	139.27	190	158.73	298
Neutral	39	23.83	12	27.17	51
Negative	39	22.90	10	26.10	49
Total	186		212		398

Fo	Fe	(Fo - Fe)	(Fo - Fe)^2	(Fo - Fe)^2/Fe
108	139.27	-31.27	977.81	7.02
39	23.83	+15.17	230.13	9.66
39	22.90	+16.10	259.21	11.32
190	158.73	+31.27	977.81	6.16
12	27.17	-15.17	230.13	8.45
10	26.10	-16.10	295.21	9.93
X^2				52.54

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